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No. -

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1988

THE NEMOURS FOUNDATION, GILBANE BUILDING COMPANY, AND THE AETNA CASUALTY & SURETY COMPANY,

Petitioners,

v.

PIERCE ASSOCIATES, INC. AND FEDERAL INSURANCE CO.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Should a federal court of appeals accord deference to a federal district court's determination of the law of the state in which it sits, particularly where the appellate panel majority is composed of a newly-appointed appellate judge and a district judge sitting by designation, both from states other than the one whose law is being determined, and three experienced district court judges on three separate occasions had determined the law of their state?

2. Where the highest court of a state has not spoken, must a federal court sitting in diversity follow a dated lower state court decision in order to determine state substantive law or may it take into account developments in state law since the lower court decision, including analogous state supreme court rulings?

3. Is a federal court sitting in diversity required to apply state substantive law as declared by the highest court of a state?

PARTIES TO THE PROCEEDING

The named appellants/cross-appellees in the United States Court of Appeals for the Third Circuit, and the only respondents here, are Pierce Associates, Inc. and Federal Insurance Co. Pierce was the mechanical subcontractor for an addition to the A.I. duPont Institute, a children's hospital in Wilmington, Delaware. Federal was Pierce's surety on a performance bond.

The named appellees/cross-appellants in the court of appeals, and the only petitioners here, are The Nemours Foundation, Gilbane Building Company, and The Aetna Casualty & Surety Company. Nemours is a charitable foundation that owns and operates the A.I. duPont Institute. Gilbane was the general contractor for the addition to the hospital. Aetna was surety on Gilbane's performance bond.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

In the twenty-one years since this Court last considered the question of how federal courts sitting in diversity should determine state substantive law, the differences among the various courts of appeals have grown wider and wider with respect to the deference due determinations made by federal district judges sitting in the state whose law is being determined, by lower state courts of that state, and even, remarkably enough, by the highest court of the state. Those differences in the circuits are in part a result of language contained

in earlier opinions of this Court and in part an example of the centrifugal action of the courts of appeals over time. The effect, however, is that litigants can no longer ascertain with any assurance how state law will be determined and applied in diversity cases.

Here the court of appeals reversed uniform rulings of three experienced Delaware district judges, followed a 1971 lower state court decision called into question by more recent Delaware Supreme Court cases and rejected by the district judges, and then sought to distinguish and refused to follow more recent Delaware Supreme Court decisions which the district judges had all followed. Accordingly, this case presents the ideal vehicle to erase the uncertainty and eliminate the conflicts among the circuits because it presents clear questions of the deference due to the federal district court in Delaware, as well as to the Delaware state courts in determining Delaware law.

OPINIONS BELOW

The United States District Court for the District of Delaware rendered numerous unreported opinions in this case during the five years in which the parties were engaged in pretrial proceedings in that court, in addition to several reported opinions. The district court Omnibus Order on Pending Motions (A44-A49) is unreported. The district court opinion (A50-A73) granting in part and denying in part Nemours' motion to dismiss Pierce's and another subcontractor's counterclaim is reported at 606 F. Supp. 995. The district court Oral Opinion and Order on Defendant's Motion for a Directed Verdict (A74-A79) is unreported. Other district court opinions not relevant to the issues before the Court are reported at 568 F. Supp. 1085; 666 F. Supp. 649; and 632 F. Supp. 418. The opinion of the United States Court of Appeals for the Third Circuit (A1-A43) is reported at 865 F.2d 530.

JURISDICTION

The judgment of the court of appeals was entered on

December 29, 1988. The order denying rehearing and suggestion of rehearing in banc was entered on February 3, 1989. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY AND CONSTITUTIONAL PROVISIONS INVOLVED

The Rules of Decision Act, 28 U.S.C. § 1652, provides:

> The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

STATEMENT OF THE CASE

In 1980, in order to construct a large addition to its children's hospital, Nemours entered into a general contract with Gilbane. As Nemours' managing contractor, Gilbane then entered into a number of subcontracts with various subcontractors, including a $36 million subcontract with Pierce for mechanical work. The Federal Insurance Company became surety on a performance bond, whose premium was paid by Nemours, naming Pierce as principal and Gilbane as obligee.

Disputes about performance under the general contract and subcontracts led to multiple lawsuits, later consolidated, in the District Court for the District of Delaware. Federal jurisdiction was based on diversity of citizenship. Included in these lawsuits were Nemours' claim for breach of contract against Gilbane based primarily on the acts and omissions of Pierce, as well as Nemours' direct claims against Pierce both as a third party beneficiary of the Gilbane/Pierce subcontract and for negligence.

District Judge James L. Latchum denied Pierce's motion to dismiss Nemours' claims against it, holding that under Delaware law both the third party beneficiary and negligence causes of action were legally sufficient (A44-A49). Judge Walter K. Stapleton, assigned when Judge Latchum took senior status, likewise recognized Nemours to be a third party beneficiary of the Gilbane/Pierce subcontract and held that, under Delaware law, negligence actions could be maintained for economic loss without privity (A72, A67).

In the midst of pretrial proceedings, at the urging of the district court, all thirteen parties engaged in an elaborate minitrial designed to bring about settlement. The result was that a multitude of claims were settled; eight parties were dismissed; and the remaining parties, Nemours, Aetna, Gilbane, Pierce, and Federal, were realigned by the district court.

To effect the settlement sought by the district court and relying on the rulings of the two Delaware federal district court judges, Nemours dismissed its breach of contract claim against Gilbane, leaving only its direct claims against Pierce. Thus, in March 1986, on the basis of the minitrial and the settlement, the case went to trial on Nemours' claims against Pierce and Federal; Gilbane's claims against Pierce and Federal; and Pierce's claims against Nemours and Gilbane. The trial lasted 79 days.

At the close of the evidence Pierce once again challenged the legal sufficiency of Nemours' third party beneficiary and negligence claims, either one of which would have supported the compensatory verdict in favor of Nemours and Gilbane. Judge Joseph J. Farnan, Jr., who had taken over the case when Judge Stapleton was appointed to the Court of Appeals for the Third Circuit, once again ruled that Nemours' direct actions against Pierce, both in contract and in tort, were properly brought under Delaware law (A75).

Thus, by the time the case went to the jury, *three* Dela-

ware district court judges had determined on *three* separate occasions that Delaware law would (1) recognize Nemours to be a third party beneficiary of the Gilbane/Pierce subcontract, and (2) permit recovery in tort for purely economic loss, without privity of contract.

The jury found in favor of Nemours and Gilbane on every one of their claims against Pierce and Federal and against Pierce and Federal on every one of their claims against Nemours and Gilbane. The jury found that Pierce had breached its contract, was grossly negligent, and had acted in an oppressive, malicious, wanton and willful manner, with a callous indifference for the harm it had caused. Judgment was entered awarding a total of over $29 million to Nemours and Gilbane, including approximately $2 million in punitive damages.

On appeal Pierce and Federal did not challenge the jury's findings in any regard and specifically did not challenge the findings with regard to their gross misconduct or the sufficiency of the evidence to support the amount of damages. Nonetheless, the panel majority of the court of appeals—a newly-appointed court of appeals judge from Pennsylvania and a district court judge from New Jersey sitting by designation—reversed, holding that the three Delaware district court judges each had erred in their state law determinations and that neither the third party beneficiary claim nor the negligence claim should have been presented to the jury (A18, A23). The dissenting judge would have affirmed the district court's ruling on the third party beneficiary issue (A41).

Thus, solely because Nemours tried its case directly against Pierce, rather than through Gilbane, the majority saddled a charitable institution with more than $24 million in damages that indisputably were the result of Pierce's wrongdoing. Moreover, in substituting its own view of state law for that of the Delaware district judges, the panel majority on one issue elevated the holding of an outdated lower state court

decision over subsequent decisions of the highest court of the state that evidenced a different view; and, on another issue, utterly disregarded controlling precedent by the highest court of the state.[1]

REASONS FOR GRANTING THE WRIT

In the fifty-one years of jurisprudence since *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938), the task of applying state law in diversity cases has led to a myriad of problems for the federal courts, many of which this Court has resolved over time. However, the Court has been virtually silent on the issue of the extent to which a court of appeals should defer to a state law determination made by the federal district court sitting in the state whose law must be determined when the state's highest court has not spoken. The Court's lack of guidance on this important issue has led to widely differing approaches by the circuits.

Moreover, while there was extensive Supreme Court discussion regarding the effect of lower state court decisions and the binding effect of decisions of the highest court of a state during the 1940's, the only substantive consideration since that time has been sporadic and has called in question the earlier decisions to some degree. The lack of guidance in these areas has created confusion among and within the circuits, a confusion that created the tragic results in this case.

As the next sections will demonstrate, this case is a striking example of how a court of appeals can go astray in ascertaining or predicting state law, and why the federal

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1. On April 21, 1989, counsel for Pierce opposed an effort to have the U.S. district court in Delaware certify to the highest state court of Delaware the same two state law questions present in this case. Transcript of argument before Judge Farnan, dated April 21, 1989, in *Nemours v. Manganaro Corp.*, C.A. 89-138. On May 5, 1989 the district court certified the question to the Delaware Supreme Court for resolution.

courts are in urgent need of current guidance from this Court in this area.[2]

I. CERTIORARI SHOULD BE GRANTED IN ORDER TO END THE CONFUSION IN THE COURTS OF APPEALS ABOUT THE WEIGHT TO BE GIVEN TO A DISTRICT COURT'S DETERMINATION OF THE LAW OF THE STATE IN WHICH IT SITS.

The panel majority gave virtually *no* weight to the Delaware state law determinations that were made independently and on three separate occasions by three Delaware federal district court judges sitting in Delaware. Instead, the majority, consisting of a newly-appointed appellate court judge from Pennsylvania and a district court judge from New Jersey sitting by designation, simply made its own determinations of Delaware law.

On the third party beneficiary issue, the majority failed even to mention the fact that three Delaware district court judges on three occasions had recognized Nemours as a third party beneficiary of the Gilbane/Pierce subcontract in accordance with Delaware law. On the negligence issue, the court of appeals did note that the Delaware district court, relying on a series of decisions of Delaware's highest court, had held that the highest court of Delaware would permit recovery in tort for economic loss absent privity of contract. However, the court of appeals chose to reject the district court's state law determination, relying instead on an outdated lower state court case and on two inapplicable federal cases.

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2. This need becomes particularly acute in view of Congress' recent reaffirmation of diversity jurisdiction. Judicial Improvements and Access to Justice Act, Pub. L. No. 100-702, §§ 201 *et. seq.* (November 19, 1988) (amending 28 U.S.C. § 1332). In 1987, in 28% of all cases filed in federal court, jurisdiction was founded on diversity of citizenship. This constituted a 5.3% increase from 1986, even though fewer cases overall were filed in federal court in 1987 than in 1986. *1987 Annual Report of the Director of the Administrative Office of the United States Courts*, 8.

This Court has never directly ruled on the issue of the weight a court of appeals should give state law determinations of a federal district court in the state in which it sits. On several occasions, however, the Court has suggested that a district court's determination of the law of its state should be reviewed with "great deference." *United States v. Hohri*, 482 U.S. 64, 74 n.6 (1987); *see also Bernhardt v. Polygraphic Co. of America*, 350 U.S. 198, 204 (1956) "([s]ince the federal judge making those findings [of Vermont law] is from the Vermont bar, we give special weight to his statement of what the Vermont law is").

The court of appeals' utter refusal to accord any deference whatsoever to the district court's state law determinations not only conflicts with this Court's teachings in *Hohri* and *Bernhardt*, but also creates the untenable result that a district court judge from one state, sitting by designation on the appellate court and joined by a newly-appointed federal appellate judge from another state, is able to reverse the considered determinations of the law of a third state made by three experienced district court judges sitting in that third state.[3] Moreover, the court of appeals' failure to give any weight to the state law determinations of the district court conflicts with the majority of the circuits that have considered the question and reveals a fundamental tension in the courts of appeals about the magnitude of deference to be accorded a district court's state law determination.

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3. The district court judges in this case, Judge Latchum, Judge Stapleton, and Judge Farnan, have among them over forty years experience as practicing attorneys in Delaware, and over forty years experience as district court judges in Delaware. Judge Latchum served as Chief Judge of the Delaware district court from 1968 through 1983. Judge Stapleton was Chief Judge of the Delaware district court from 1983 until 1985, when he was appointed to the United States Court of Appeals for the Third Circuit. Judge Farnan was the United States Attorney in Delaware from 1981 until 1985, when he was appointed to the United States District Court for the District of Delaware.

Because the determination of state law where the highest court in the state has not spoken is, in a larger sense, a factual determination, many courts of appeals treat the state law determinations of district courts as binding unless clearly erroneous. This approach appears particularly prevalent in the Fifth, Eighth, and Tenth Circuits. *See, e.g., Weatherhead v. Globe International, Inc.*, 832 F.2d 1226, 1228 (10th Cir. 1987); *Bridgman v. Cornwell Quality Tools Co.*, 831 F.2d 174, 175 (8th Cir. 1987); *Hauser v. Public Service Co.*, 797 F.2d 876, 878 (10th Cir. 1986); *Harville v. Anchor-Wate Co.*, 663 F.2d 598, 602 (5th Cir. 1981); *Hartzell v. United States*, 539 F.2d 65, 68 (10th Cir. 1976); *Harris v. Hercules, Inc.*, 455 F.2d 267, 269 (8th Cir. 1972); *Hogue v. Pellerin Laundry Machinery Sales Co.*, 353 F.2d 772, 776 (8th Cir. 1965); *Kirby v. United States*, 329 F.2d 735, 737 (10th Cir. 1964).[4]

The court of appeals here, on the other hand, applied a plenary standard of review to the district court's state law determination, and rejected the concept of deference altogether. This approach also has been followed in the Ninth Circuit, for example, in *Matter of McLinn*, 739 F.2d 1395 (9th Cir. 1984) (in banc), where the court flatly rejected the concept of deference to a district court's state law determination, holding that "our appellate review of conclusions of state law should be under the same independent de novo standard as conclusions of federal law." *Id.* at 1403.[5]

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4. Other courts of appeals, while according considerable deference to district court determinations of state law, apply a standard of review slightly different from the clearly erroneous standard. The Sixth Circuit, for example, has long followed the view that "if a federal district judge has reached a permissible conclusion upon a question of local law, the Court of Appeals should not reverse, even though it may think the law should be otherwise." *Rudd-Melikian, Inc. v. Merritt*, 282 F.2d 924, 929 (6th Cir. 1960); *see also Agristor Leasing v. Saylor*, 803 F.2d 1401, 1407 (6th Cir. 1986); *Louisville & Jefferson County Metropolitan Sewer Dist. v. Travelers Insurance Co.*, 753 F.2d 533, 540 (6th Cir. 1985).

5. *McLinn* overruled numerous Ninth Circuit opinions that had applied a deferential standard of review to a district court's state law determi-

The fact that a court of appeals applies a plenary standard of review does not necessarily mean that it will not show deference to district court determinations of state law. Thus, the Third Circuit has consistently applied a plenary standard of review to district court determinations of state law, as it did here, *see, e.g., Santiago v. Johnson Machine & Press Corp.*, 834 F.2d 84, 85 (3d Cir. 1987); *Blum v. Witco Chemical Corp.*, 829 F.2d 367, 376 (3d Cir. 1987); *Saludes v. Ramos*, 744 F.2d 992, 994 (3d Cir. 1984); *Compagnie des Bauxites v. Insurance Co. of North America*, 724 F.2d 369, 371 (3d Cir. 1983), but has still recognized a need for deference to a district court judge's state law determination in some of those cases, *see, e.g., Saludes, supra*, 744 F.2d at 994 ("district judge's prediction of state law is weighty because of his or her familiarity with the particular jurisdiction"); *Compagnie des Bauxites, supra*, 724 F.2d at 371 ("[a]lthough our review is plenary, this does not mean that in discharging our function we will not take into consideration the district judge's prediction of the law in the state in which he sits").

The courts of appeals clearly are uncertain about the weight to be accorded a district court's determination of the law of the state in which it sits. This Court should grant review not only to resolve this uncertainty, but also to rule that courts of appeals must give deference to district court determinations of the law of their states and to rectify the egregious result reached in this case.

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nation, accepting that determination unless it was "clearly wrong." *See, e.g., Jablonski by Pahls v. United States*, 712 F.2d 391, 397 (9th Cir. 1983); *Monte Carlo Shirt, Inc. v. Daewoo International (America) Corp.*, 707 F.2d 1054, 1056-57 (9th Cir. 1983); *In re Mistura, Inc.*, 705 F.2d 1496, 1497 (9th Cir. 1983); *Camacho v. Civil Service Commission*, 666 F.2d 1257, 1262 (9th Cir. 1982); *Gaines v. Haughton*, 645 F.2d 761, 770 (9th Cir. 1981), *cert. denied*, 454 U.S. 1145 (1982).

II. CERTIORARI SHOULD BE GRANTED IN ORDER TO END THE CONFUSION IN THE FEDERAL COURTS SITTING IN DIVERSITY ABOUT HOW TO DETERMINE STATE LAW AS MANDATED BY *ERIE RAILROAD v. TOMPKINS*.

A. This Case Evidences a Fundamental Confusion in the Federal Courts Regarding the Effect of Lower State Court Decisions on Federal Courts Sitting in Diversity.

It is patent that the court of appeals misapplied Delaware law on the negligence issue. Of more serious concern to this Court, however, is that that misapplication grew out of a fundamental confusion regarding the effect of lower state court decisions under *Erie*. This Court should grant review to end this confusion.

On the issue of whether Nemours could recover in tort for the economic losses indisputably caused by Pierce's misconduct, the court of appeals apparently felt bound by a single lower state court ruling handed down eighteen years ago that required privity before purely economic losses could be recovered for negligence. While acknowledging that "[o]ur role in this case is predictive," and that "decisions of intermediate state courts . . . are not conclusive," (A20), the court of appeals nevertheless elevated an outdated lower state court ruling over more recent decisions of Delaware's highest court which indicated that that court would be unlikely to follow the lower court's decision, and, bolstered by an inapplicable federal admiralty case, reversed the rulings of the three Delaware district court judges sitting below, thus stripping Nemours of a jury award achieved after many months of trial.

The highest court of Delaware has given every indication that it would allow recovery in tort for economic loss regardless of privity. In *Martin v. Ryder Truck Rental, Inc.*, 353 A.2d 581 (Del. 1976), the Supreme Court of Delaware abol-

ished the common law privity requirement in products liability cases, thereby overruling the Delaware cases that had erected a bar, based on lack of privity, to products liability suits. *See, e.g., Ciociola v. Delaware Coca-Cola Bottling Co.*, 172 A.2d 252, 256-57 (Del. 1961).

In *Seiler v. Levitz Furniture Co.*, 367 A.2d 999 (Del. 1976), the same court held that a tenant of a shopping center could recover in negligence against the shopping center's architect for design defects that resulted in flood damage to the tenant's store. The Delaware high court stated: "as to privity, the case against [the architect] was tried on a negligence basis (not on a contract theory) and, to the extent [the architect] relies on the absence of privity in product liability cases, the argument is without merit in light of our recent decision in *Martin*." 367 A.2d at 1007 (citation omitted).

From these cases, Judge Stapleton, a former Delaware lawyer sitting as a Delaware district court judge in this case, determined that "the Delaware Supreme Court in *Seiler*, by relying on *Martin*, was likewise indicating an intent to abandon privity as a prerequisite to bringing suit on a negligence theory to recover financial losses suffered in the construction context." 606 F. Supp. at 1005. Thus, Judge Stapleton concluded that the Supreme Court of Delaware would permit recovery in tort for economic loss absent privity of contract.

Not only did the court of appeals disregard Judge Stapleton's considered state law determination, on which the two other Delaware district judges in this case had agreed, but it also failed to give proper regard to this controlling body of Delaware law. It ignored *Martin* completely. It stated that *Seiler* was inapplicable because the *Seiler* court had held, expressly as an alternative to its ruling on the negligence issue, that the architect was also liable to the tenant under third party beneficiary principles.

Instead, the court of appeals relied upon a single, out-

dated lower state court decision, *Crowell Corp. v. Topkis Construction Co.*, 280 A.2d 730 (Del. Super. 1971). In *Crowell*, the Superior Court of Delaware, sitting as a trial court, prohibited recovery in tort for economic loss absent privity. Not only was *Crowell* decided without the benefit of the Delaware Supreme Court's later and patently contrary holdings in *Martin* and *Seiler*, but also it was decided at a time when the privity requirement was firmly established in Delaware law. *See Ciociola, supra*, 172 A.2d at 256-57. The *Crowell* court simply was not free to depart from the *Ciociola* privity requirement, as the court itself reluctantly recognized. *See Crowell*, 280 A.2d at 731 ("[f]rom a social viewpoint there is much to be said in favor of the approach taken by plaintiff but the case law does not support plaintiff's position"). Significantly, *Crowell* has been cited by Delaware courts in only one case in the eighteen years since it was decided.[6]

The court of appeals sought to bolster its holding by noting "significant developments in the law on this issue since the date of [Judge Stapleton's decision]" (A19-A20). But the only developments cited, *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986), *a federal admiralty case*, and *Aloe Coal Co. v. Clark Equipment Co.*, 816 F.2d 110 (3d Cir.), *cert. denied*, 108 S.Ct. 156 (1987), a diversity case predicting *Pennsylvania* law, have absolutely no rele-

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6. In *Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver Inc.*, 312 A.2d 322 (Del. Super. 1973), the Superior Court of Delaware permitted an owner to sue a subcontractor for negligent workmanship regardless of privity of contract. The court distinguished *Crowell* on the ground that the case before it involved physical injury to property and the subsequently incurred costs of repair and replacement, *id.* at 329 -- precisely the type of damages proven by Nemours in this case. The Supreme Court of Delaware, affirming the final order in the case, held that the owner was a third party beneficiary of the subcontract. *Oliver B. Cannon & Son, Inc. v. Dorr-Oliver, Inc.*, 336 A.2d 211, 215-16 (Del. 1975). On the negligence issue, the court noted that: "[t]he decision as to [the owner's] status and its privity of contract obviates the need to consider arguments of the parties relating to *Crowell*. . . . On remand the parties are free to argue a tortious basis for damages in any way that is not inconsistent with this opinion." *Id.* at 216 n.6 (citation omitted).

vance to the determination of Delaware law. In effect, the two-judge majority has resuscitated federal common law, the very approach repudiated by *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938).

The court of appeals' approach is but the most recent evidence of a fundamental disorder in the federal courts regarding the effect of lower state court decisions on federal courts sitting in diversity.

This Court in *Erie* held that the Rules of Decision Act, now codified at 28 U.S.C. § 1652, required federal courts sitting in diversity to apply not only state statutes, but also state common law. Under *Erie*, federal courts sitting in diversity have been obliged to apply state law, whether that law "shall be declared by its Legislature in a statute *or by its highest court* in a decision." 304 U.S. at 78 (emphasis added).

Erie and its progeny also made clear that if the highest court of a state is silent on a particular issue, the federal courts must predict what the highest court of a state would do. *See Commissioner v. Estate of Bosch*, 387 U.S. 456, 465 (1967); *Fidelity Union Trust Co. v. Field*, 311 U.S. 169, 177 (1940).[7]

The problem that has arisen, however, is what a federal court's responsibility is when the highest state court has not spoken directly on an issue, but there exist lower state court decisions on point. On this issue, this Court unfortunately has given mixed messages and the circuits are hopelessly confused and inconsistent.

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7. One federal appellate court judge, discussing the "unenviable task" of a federal court sitting in diversity when the highest court of a state is silent, has remarked that "[o]n occasions such as these, trial judges are asked to be omniscient in a way that is not possible for mortals." *Santiago v. Johnson Machine & Press Corp.*, 834 F.2d 84, 84 (3d Cir. 1987) (Higginbotham, J.).

A series of decisions in the 1940's held that, in the absence of clear direction from the state's highest court, the decisions of lower state courts are binding on federal courts sitting in diversity. *See Stoner v. New York Life Insurance Co.*, 311 U.S. 464, 467 (1940); *West v. American Telephone & Telegraph Co.*, 311 U.S. 223, 237 (1940); *Six Cos. v. Joint Highway District No. 13*, 311 U.S. 180, 188 (1940); *Fidelity Union Trust Co. v. Field, supra*, 311 U.S. at 177-78; *see generally* Note, *Binding Effect of Intermediate State Court Decisions on Federal Courts*, 9 Geo. Wash. L. Rev. 458 (1941).[8]

After the *Field* era, the task seemed easy enough for federal courts sitting in diversity: if the highest court of the state was silent, but a lower state court had spoken, federal courts were bound to follow the lower state court, even though the highest court of the state would be free to do otherwise.

However, the two Supreme Court opinions since the 1940's dealing with the effect to be given lower state court decisions when the highest court of a state has not spoken took away the certainty on the issue. In *King v. Order of United Commercial Travelers of America*, 333 U.S. 153, 160-61 (1948), the Court held that a decision of a lower state court was entitled to "some weight" but was "not controlling" on federal courts. And in *Commissioner v. Estate of Bosch*, 387 U.S. 456, 465 (1967), relying, *inter alia*, on *King* and over a strong dissent founded on the *Field* doctrine, the Court stated that:

> [U]nder some conditions, federal [courts] may not be

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8. In *Field*, which is perhaps the most striking example of this line of cases, the Court stated that:

> An intermediate state court in declaring and applying the state law is acting as an organ of the State and its determination, in the absence of more convincing evidence of what the state law is, should be followed by a federal court in deciding a state question.

Field, 311 U.S. at 177-78.

> bound even by an intermediate state appellate court ruling. It follows here then, that when the application of a federal statute is involved, the decision of a state trial court as to an underlying issue of state law should *a fortiori* not be controlling. . . . If there be no decision by [the highest court of the state] then federal [courts] must apply what they find to be the state law after giving "proper regard" to relevant rulings of other courts of the State.

The effect of *King* and *Bosch* was to leave the federal courts sitting in diversity without clear direction regarding the effect to be given lower state court rulings. Nevertheless, this Court has not directly addressed the issue of the effect of lower state court decisions since *Bosch*. The result has been that courts of appeals have taken inconsistent and widely varying approaches.

Some courts of appeals, for example, consider themselves absolutely bound by lower state court decisions. Thus, the court in *Birmingham Fire Insurance Co. v. Winegardner & Hammons, Inc.*, 714 F.2d 548, 550 (5th Cir. 1983) (emphasis in original), stated that, "when the supreme court of a state has not spoken to a particular issue, the well-established practice of this Circuit is to follow the opinion of the highest court which *has* written on the matter." *See also Burrus v. Young*, 808 F.2d 578, 581 (7th Cir. 1986); *Studstill v. Borg Warner Leasing*, 806 F.2d 1005, 1007 (11th Cir. 1986); *Hill v. Bache Halsey Stuart Shields Inc.*, 790 F.2d 817, 827 (10th Cir. 1986); *Allen v. A. G. Edwards & Sons, Inc.*, 606 F.2d 84, 87 (5th Cir. 1979); *Farmer v. Travelers Indemnity Co.*, 539 F.2d 562, 563 (5th Cir. 1976); *Continental Grain Co. v. Martin*, 536 F.2d 592, 593 (5th Cir.), *cert. denied*, 429 U.S. 1024 (1976).

Other courts of appeals, reflecting this Court's direction in *Field*, follow the rule that they are bound by lower state court decisions, "unless . . . convinced by other persuasive data that the highest court of the state would decide otherwise." *Kochins v. Linden-Alimak, Inc.*, 799 F.2d 1128, 1140

(6th Cir. 1986). *See, e.g., Miller v. Fairchild Industries, Inc.*, 797 F.2d 727, 735 (9th Cir. 1986); *Provau v. State Farm Mutual Automobile Insurance Co.*, 772 F.2d 817, 820 (11th Cir. 1985); *McCoy v. Richards*, 771 F.2d 1108, 1110 (7th Cir. 1985); *O'Neil v. Great Plains Women's Clinic, Inc.*, 759 F.2d 787, 790 (10th Cir. 1985); *Flintkote Co. v. Dravo Corp.*, 678 F.2d 942, 945 (11th Cir. 1982); *Delano v. Kitch*, 663 F.2d 990, 996 (10th Cir. 1981), *cert. denied*, 456 U.S. 946 (1982).

A third group of courts of appeals regard lower state court rulings as somewhat less important in ascertaining state law. *See, e.g., General Electric Credit Corp. v. Ger-Beck Machine Co.*, 806 F.2d 1207, 1209 (3d Cir. 1986) ("significant weight"); *Sarnoff v. American Home Products Corp.*, 798 F.2d 1075, 1084 (7th Cir. 1986) ("significant evidence"); *Ciccarelli v. Carey Canadian Mines, Ltd.*, 757 F.2d 548, 553 n.3 (3d Cir. 1985) ("federal court must consider and give due regard"); *Mathis v. Eli Lilly & Co.*, 719 F.2d 134, 141 n.15 (6th Cir. 1983) ("datum not to be disregarded by the federal court"); *Coleman v. Western Electric Co.*, 671 F.2d 980, 983 (6th Cir. 1982) ("an *Erie* indicator"); *see also Dale Baker Oldsmobile, Inc. v. Fiat Motors of North America*, 794 F.2d 213, 218 (6th Cir. 1986).

The confusion in the courts of appeals on this important issue is attributable to this Court's uneven direction. That confusion created a climate in which the court of appeals in this case felt free to elevate an outdated lower state court ruling over the more recent teachings of the state's highest court. This unpredictability and conflict among circuits can be corrected only by clear direction from this Court whose seemingly contradictory decisions are the basis for these conflicts. For these reasons, this Court should grant review here.

B. This Case Evidences a Fundamental Confusion in the Federal Courts Regarding Whether Decisions of a State's Highest Court Are Binding on Federal Courts Sitting in Diversity.

Whatever its effect on lower state court decisions, *Erie*

seemed to make clear that the decisions of the *highest* courts of the states are binding on federal courts sitting in diversity. In this case, however, the panel majority disregarded the decisions of the highest court of Delaware on the third party beneficiary issue, suggesting the danger that the clarity of *Erie* may be being diluted by the passage of time.

The highest court of Delaware has firmly established that the intent to confer third party beneficiary status is to be determined from the language of the contract, and only from the language of the contract. *See Oliver B. Cannon & Son, Inc. v. Dorr-Oliver, Inc.*, 336 A.2d 211, 215 (Del. 1975); *Royal Indemnity Co. v. Alexander Industries, Inc.*, 211 A.2d 919, 920 (Del. 1965); *see also Sears, Roebuck & Co. v. Jardel Co.*, 421 F.2d 1048, 1054 (3d Cir. 1970) (applying Pennsylvania law, but cited with approval in *Cannon*).

Acknowledging this requirement under Delaware law, the panel majority nonetheless relied on a host of factors external to the contract, offering as support for its approach, unprecedented under Delaware law, only its belief that "[t]he language of a contract . . . cannot be divorced from the context in which it was written" (A10). It was the majority's unauthorized examination of that "context"—including the nature of the construction industry, a letter from Nemours to Gilbane, the language of the Pierce/Federal performance bond, the pattern of the litigation itself, and provisions in the Nemours/Gilbane general contract—that led it to conclude that "the subcontract does not manifest an intent by Pierce and Gilbane to confer third party beneficiary status on Nemours" (A18).

As Judge Sloviter's dissent noted, had the panel majority followed the rulings of Delaware's highest court, it would have found "sufficient evidence under Delaware law . . . that Gilbane and Pierce intended to make Nemours a beneficiary of the subcontract" (A40). Indeed, had the panel majority taken as its frame of reference the state cases on point, such

as *Cannon*, it would have found that the precise indicia of intent to create third party beneficiary status identified as significant in those cases also appeared in the Gilbane/Pierce subcontract—as the Delaware district judges who reviewed and applied Delaware law on this issue had determined.[9]

Rather than rely on *Cannon*, however, the panel majority sought to distinguish it, and did so in a single paragraph, in disarmingly conclusory terms: "What distinguishes the present case from *Cannon* is Pierce's and Gilbane's expressed intent that there be no third party beneficiary relationship between Pierce and Nemours" (A17). Because, however, the majority divined that "intent" from sources external to the language of the subcontract itself, the alleged distinction is meaningless under Delaware law.

The panel majority's disregard of decisions of the highest court of Delaware reflects the uncertainty that has developed in the fifty-one years of *Erie* jurisprudence on the issue of whether and to what degree decisions of a state's highest court are binding on federal courts sitting in diversity. It seems likely that the panel majority felt free to avoid the Delaware Supreme Court's decision in Cannon because this Court has suggested on at least two occasions, albeit in dicta, that some circumstances may exist in which decisions of a state's highest court may not be controlling on federal courts sitting in diversity. Even so, why the panel majority would employ this occasion to deprive a non-profit children's hospital of a $29 million jury verdict is, at the very least, puzzling.

The Court first suggested that the *Erie* rule might not be

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9. For example, in *Cannon*, a case holding that the owner was the third party beneficiary of the subcontract between the general contractor and the subcontractor, the highest court of Delaware emphasized that the subcontract identified the owner (as in the Gilbane/Pierce subcontract); contained an indemnification clause whereby the subcontractor would indemnify the owner against certain losses (as in the Gilbane/Pierce subcontract); and contained a warranty clause running from the subcontractor to the owner (as in the Gilbane/Pierce subcontract). 336 A.2d at 215.

absolute in *Meredith v. City of Winter Haven*, 320 U.S. 228, 234 (1943): "the rulings of the Supreme Court of Florida . . . must be taken as controlling here unless it can be said with some assurance that the Florida Supreme Court will not follow them in the future . . . ." Similarly, in *Bernhardt v. Polygraphic Co. of America*, 350 U.S. 198, 205 (1956), the Court held that a 1910 decision of the highest court of Vermont was controlling, but qualified its holding by adding: "there appears to be no confusion in the Vermont decisions, no developing line of authorities that casts a shadow over the established ones, no dicta, doubts or ambiguities in the opinions of Vermont judges on the question, no legislative development that promises to undermine the judicial rule."

The uneven direction by the Court on this issue has led some courts of appeals to depart sporadically from the decisions of the highest court of the state whose law they are applying. *See, e.g., Miller v. Premier Corp.*, 608 F.2d 973, 985-87 (4th Cir. 1979); *Mason v. American Emery Wheel Works*, 241 F.2d 906, 909-10 (1st Cir.), *cert. denied*, 355 U.S. 815 (1957); *see also Roginsky v. Richardson-Merrell, Inc.*, 378 F.2d 832, 851 (2d Cir. 1967). Other courts have considered themselves absolutely bound by *Erie* to apply the decisions of the highest court of the state, regardless of the circumstances. *See, e.g., Ciccarelli v. Carey Canadian Mines, Ltd.*, 757 F.2d 548, 553 n.3 (3d Cir. 1985); *Birmingham Fire Insurance Co. v. Winegardner & Hammons*, 714 F.2d 548, 551 (5th Cir. 1983); *see also Rhynes v. Branick Manufacturing Corp.*, 629 F.2d 409, 410 (5th Cir. 1980) ("[i]n matters of Texas substantive law, our relationship to the Texas Supreme Court is all but identical to that of a Texas intermediate appellate court").

This Court should grant review because the uneven direction on the issue of the binding effect of decisions of the highest court of a state has led to uncertainty among the courts of appeals. In this case, it is clear that on the third party beneficiary issue, as on the negligence issue, the panel majority simply substituted its own view of what Delaware

law should be for what Delaware law actually is. It is the lack of direction from this Court that created the climate in which the majority felt free to do so.

CONCLUSION

This case represents a serious deviation from *Erie*. The panel majority of the court of appeals gave no weight to the district court's determinations of state law, made independently by three highly regarded Delaware judges. Moreover, the court of appeals on one issue elevated the holding of an outdated lower court case over more recent decisions by the highest court of the state that evidenced a different view, and, on the other, completely disregarded precedent from the highest court of the state. Rendered in an atmosphere of confusion about the role of a district court's state law determinations and about whether or not lower state court decisions or even the decisions of the highest courts of the states are in fact binding on federal courts sitting in diversity, this ruling calls out for review.

Respectfully submitted,

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May 3, 1989

88- 1790

Supreme Court, U.S.
FILED
MAY 4 1989
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CLERK

No. -

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1988

THE NEMOURS FOUNDATION, GILBANE BUILDING COMPANY, AND THE AETNA CASUALTY & SURETY COMPANY,

Petitioners,

v.

PIERCE ASSOCIATES, INC. AND FEDERAL INSURANCE CO.,

Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 88-3053, 88-3260, 88-3263

PIERCE ASSOCIATES, INC. and
FEDERAL INSURANCE CO.,

Appellants and Cross-Appellees

v.

THE NEMOURS FOUNDATION,
GILBANE BUILDING COMPANY, and
THE AETNA CASUALTY & SURETY COMPANY,

Appellees and Cross-Appellants

Appeal from the United States
District Court for the
District of Delaware
(D.C. Civil No. 83-58)

Argued: October 17, 1988

Before: SLOVITER and HUTCHINSON, *Circuit Judges*,
and DEBEVOISE, *District Judge**

(Filed: December 29, 1988)
(As Amended January 6, 1989)

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*Honorable Dickinson R. Debevoise, United States District Judge for the District of New Jersey, sitting by designation.

OPINION OF THE COURT

DEBEVOISE, District Judge.

I. *The Parties and the Proceedings*

The Nemours Foundation ("Nemours") owns the Alfred I. duPont Institute Children's Hospital in Wilmington, Delaware. In January 1980 Nemours entered into a general contract with Gilbane Building Company ("Gilbane") for completion of the interior of the Hospital. The Aetna Casualty & Surety Company ("Aetna") became surety on a performance bond which named Gilbane as principal and Nemours as obligee.

Gilbane entered into a number of subcontracts, including a $35.9 million fixed-price subcontract with Pierce Associates, Inc. ("Pierce") pursuant to which Pierce agreed to perform the mechanical work on the project (the heating, ventilation, air-conditioning, plumbing and fire-protection systems). Federal Insurance Company ("Federal") became surety on a performance bond which named Pierce as principal and Gilbane as obligee.

Disputes arose about performance under the general contract and under the subcontracts, and complex multiparty litigation ensued. During pretrial proceedings there were various changes in the parties' positions and realignments of adversaries which resulted in a trial at which Nemours and its general contractor Gilbane (joined by its surety Aetna) were plaintiffs seeking damages against Gilbane's subcontractor Pierce and Pierce's surety Federal.

After a 79 day trial the jury found in favor of Nemours and Gilbane on all their claims against Pierce and Federal and found against Pierce on its counterclaims. On September 15, 1986 final judgment was entered awarding $26,017,411 in damages and pre-judgment interest to Nemours and $3,018,372 in damages and pre-judgment interest to Gilbane.

The total judgment amount of $29,035,783 was on account of the following items:

Against Pierce and Federal	
For Nemours on account of Pierce's breach of its subcontract with Gilbane and Pierce's negligence and on account of Federal's obligation on its performance bond (plus pre-judgment interest)	$19,045,982
For Gilbane on account of Pierce's breach of the subcontract with it and on account of Federal's obligation on its performance bond	2,066,699
For Gilbane on account of interest on the award of $2,066,699 at the rate of 13½% from April 18, 1983 to the date of judgment	951,673
	$22,064,354
For Nemours Against Pierce Only	
On certain indemnity claims	$ 3,375,000
Pre-judgment interest on indemnity claims	1,554,118
Punitive damages	1,000,000
Attorney's fees and consultant's costs	1,042,311
	$ 6,971,429

After resolution of their post-trial motions for judgment n.o.v. or for a new trial Pierce and Federal filed a notice of appeal from the final judgment on January 26, 1988. Subsequently this Court remanded the case for adjudication of a Rule 60(b) motion which Pierce and Federal had filed challenging the rate of post-judgment interest in the final judgment. The district court granted the motion on April 4, 1988 and reduced the post-judgment interest rate from 10.5% to 5.63%. On April 15, 1988, the district court denied a second Rule 60(b) motion filed by Pierce and Federal which challenged the imposition of post-judgment interest on pre-judgment interest. Nemours, Gilbane and Aetna appeal from the

order granting the reduction of post-judgment interest. Pierce and Federal appeal from the order denying the motion for relief from the award of post-judgment interest on pre-judgment interest.[1]

We conclude as follows: (i) The award of $19,045,982 in favor of Nemours against Pierce must be reversed for the reason that Nemours has neither a contract claim nor a negligence claim against Pierce. (ii) The award of $19,045,982 in favor of Nemours against Federal must be reversed for the reason that Federal's liability is dependent upon and derivative of Pierce's liability. (iii) The award of $2,066,699 for contract damages in favor of Gilbane and against Pierce and Federal will be reversed to the extent it represents delay liquidated damages and affirmed to the extent it represents recovery of $269,699 in back charges. (iv) The award of pre-judgment interest on $269,699 in favor of Gilbane and against Pierce will be reversed and remanded for recomputation of interest in accordance with applicable Delaware law. (v) The awards in favor of Nemours and against Pierce on the indemnity claims and interest thereon and for punitive damages, attorneys' fees and consultants' costs will be reversed. (vi) To the extent that they are still applicable, the district court's orders granting Pierce's and Federal's motion to reduce post-judgment interest and denying Pierce's and Federal's motion for relief from the award of post-judgment interest on pre-judgment interest will be affirmed.

The court has jurisdiction under 28 U.S.C. § 1291.

II. *The Background*

These appeals do not challenge the sufficiency of the

1. The district court's order granting Pierce's and Federal's motion to reduce post-judgment interest is the subject of the appeal in Docket No. 88-3260. The district court's order denying Pierce's and Federal's motion for relief from the award of post-judgment interest on pre-judgment interest is the subject of the appeal in Docket No. 88-3263. All other matters under appeal are encompassed in the appeal in Docket No. 88-3053.

evidence. Rather, they challenge the legal sufficiency of the claims submitted to the jury and concern legal rulings of the trial court. The facts upon which these rulings were based are not in dispute.

As recited above, in January 1980 Nemours entered into a general contract with Gilbane to complete the interior of its Children's Hospital. This contract includes the American Institute of Architects' "General Conditions of the Contract of Construction" (1976 ed.) (the "AIA General Conditions"). Article 1.1.2 of the AIA General Conditions states:

> Nothing contained in the Contract Documents shall create any contractual relationship between the Owner [Nemours] or the Architect and any Subcontractor or Sub-subcontractor.

Gilbane in turn entered into a number of subcontracts. The largest was its $35.9 million fixed-price subcontract with Pierce, executed in June 1980 which called for Pierce to perform the mechanical work on the project. Gilbane entered into other subcontracts including a $19.7 million subcontract with Dynalectric Company ("Dynalectric") for electrical work and an $8.6 million subcontract with Honeywell, Inc. ("Honeywell") for installation of the building management systems.

Section 1 of the Gilbane-Pierce subcontract provided that Pierce would "furnish all materials and perform all work as described in Section 2 hereof for Phase 5B: A.I. duPont Institute for the Nemours Foundation Hospital Building . . . all in accordance with the Drawings and Specifications . . . and subject in every detail to the supervision and satisfaction of [Gilbane] and of [Nemours] or his duly authorized representative."

The subcontract provided in Section 6 that "[Pierce] agrees to be bound to [Gilbane] by the terms and conditions of

this Agreement, the Drawings and Specifications, the General Contract and the General Conditions for construction . . . , and to assume toward [Gilbane] all the obligations and responsibilities that [Gilbane], by these documents, assumes toward [Nemours]." The General Conditions, of course, contained the provision that nothing contained in the "Contract Documents" shall create any contractual relationship between Nemours and any subcontractor.

A number of provisions in the subcontract, particularly those found in Section 7, imposed upon Pierce specific obligations vis-a-vis Nemours. For example: Section 7(a) requires Pierce to "furnish Shop Drawings, Erection Drawings, Details, Samples, etc.," for Nemours' approval. Section 7(b) bestowed upon Nemours the right to agree on lump sum pricing of changes to Pierce's work. Section 7(c) gave Nemours the right to inspect and condemn Pierce's work and required Pierce to "make good" the condemned work at its own expense. Section 7(e) required Pierce to "indemnify and save harmless" Nemours from any expenses, liability or loss arising from patent, copyright or trademark infringement.

After the terms of the Gilbane–Pierce subcontract were agreed upon, Gilbane sent it to Nemours for approval. By letter dated September 9, 1980 Nemours approved the subcontract and also stated, "[b]y this approval, The Nemours Foundation does not waive, and expressly reserves all of its rights and remedies under said contract and nothing herein shall be deemed or construed to create any contractual relationship between The Nemours Foundation and said subcontractor." At the foot of the letter Gilbane executed the following: "Receipt and Acceptance acknowledged this 19th day of September, 1980."

Pursuant to the requirements of the subcontract Pierce furnished Gilbane a performance bond naming Pierce as principal, Federal as surety and Gilbane as obligee. Two provisions are pertinent to the present case. The bond provides,

"No right of action shall accrue on this bond to or for the use of any person or corporation other than the Obligee named herein or the heirs, executors, administrators or successors of the Obligee." Immediately after that provision there appears the following: "Provided, however, that this Performance Bond issued on behalf of the named Principal may not be assigned to any party other than the Owner, The Nemours Foundation, without the consent of the Sureties." The bond was never assigned to Nemours.

Gilbane and its subcontractors commenced performance under their respective contracts. Serious delays ensued, the causes of which were the subject of vigorous disagreement. The delays and disputes over contract plans and specifications, design revisions, job progress schedules, progress payments and change orders resulted in Nemours withholding payments. In response, in April 1983 Pierce suspended performance under the subcontract. Although the other subcontractors asserted claims against Gilbane and Nemours, they stayed on the job.

To meet the situation created by Pierce's abandonment of the job, Nemours hired contractors to correct and finish Pierce's work under the direction of Turner Construction Company ("Turner"). Gilbane and its other subcontractors coordinated with Turner and the completion contractors to finish the Hospital. Substantial completion took place by December 1984 twenty-one months late.

Not surprisingly, litigation ensued. It was carried on while the Hospital was being completed and thereafter. On April 5, 1983 Gilbane filed a complaint against Nemours and its architect and engineer alleging breach of contract, breach of warranty and negligence. Gilbane sought compensation for delay damages suffered by it and its subcontractors.

It would appear that at that time Gilbane and certain of its subcontractors, including Pierce, were working in tandem.

On the day Gilbane filed its complaint against Nemours, Pierce and the electrical contractor, Dynalectric, filed similar breach of contract actions against Gilbane and its surety, Aetna, seeking compensation for delay, for changed and added work and for monies wrongfully withheld. Honeywell, the management systems subcontractor, filed a similar complaint against Gilbane sometime later.

In Gilbane's action, counterclaims were filed against it by Nemours and its architect and engineer. In the subcontractors' actions, Gilbane filed counterclaims for indemnification and contribution and also impleaded Nemours and its architect and engineer. Nemours, in turn, filed counterclaims against Gilbane.

Nemours also filed breach of contract and negligence claims directly against Gilbane's subcontractors and their sureties, alleging that it was a third party beneficiary of the subcontracts and of the surety bonds. Pierce and Dynalectric moved to dismiss Nemours' claims against them on the ground that there was no third party beneficiary relationship between Nemours and them, and Nemours could not recover on a negligence theory for purely economic loss. On March 15, 1984 the district court denied the motions.[2] Pierce and Dynalectric then answered Nemours' claims and filed counterclaims against it.

Up to that point and for some time thereafter the positions of Gilbane and its subcontractors, despite the claims asserted against each other, appeared to be in substantial alignment. That is to say, they attributed responsibility for the delays and other difficulties to Nemours and its architect and engineer. In March 1985 Gilbane settled with Nemours and

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2. The district judge who tried the case was assigned to it less than a year before commencement of trial. He was the fourth judge assigned to the case, and most of the pretrial motions were decided by the preceding judges.

its architect and engineer, joining with them in asserting claims against Pierce. Pursuant to the settlement, Gilbane received $4,025,000, of which Nemours paid $3,375,000, Nemours' architect paid $300,000, and its engineer paid $350,000. Gilbane in turn paid the aggregate sum of $3,669,000 to settle the delay claims asserted by Dynalectric, Honeywell and other smaller subcontractors, retaining $356,000 for itself. The settlement agreement further provided that Gilbane would be entitled to share with Nemours on a 50–50 basis the first $8,000,000 of any possible recovery from Pierce.

A recital in the settlement agreement stated that the parties to it were of "the strong opinion and belief" that the primary causes of the delays to the completion of the project and of the damages incurred by them were attributable to Pierce's breaches of contract, negligence and, in the opinion of Nemours, fraud on Pierce's part. Gilbane promised in the settlement agreement to cooperate with Nemours in its action against Pierce by forsaking any claim or defense based on Nemours' action, to seek commitments from its subcontractors in their settlement agreements to cooperate with Nemours in a similar fashion, and to refrain from settling with Pierce or Federal without Nemours' written consent.

In order to reflect the realignment of the parties resulting from the settlement, the district court designated Nemours and Gilbane as co-plaintiffs and Pierce and Federal as the defendants. On November 4, 1985 the district court denied Pierce's motion to dismiss Nemours' claim seeking indemnification for the $3,375,000 which Nemours had paid in settlement.

A trial by jury commenced on March 31, 1986. The results are reflected in the final judgment described in Part I above.

III. *Third Party Beneficiary Claims*

It must first be determined whether the district court erred as a matter of law by holding that Nemours was a third

party beneficiary of the Gilbane-Pierce subcontract.[3] Since this issue involves only a question of law the standard of review is plenary. This being a diversity of citizenship case brought pursuant to 28 U.S.C. § 1332, this and the other substantive issues are controlled by Delaware law.

"It is well settled in Delaware that a third-party may recover on a contract made for his benefit. . . . But in order for there to be a third party beneficiary, the contracting parties must intend to confer the benefit." *Ins. Co. of North America v. Waterhouse*, 424 A.2d 675, 679 (Del.Super. 1980). The intent to confer a third party beneficiary benefit is to be determined from the language of the contract. *Oliver B. Cannon & Sons, Inc. v. Dorr–Oliver, Inc.*, 336 A.2d 211, 215 (Del.1975); *Royal Indemnity Co. v. Alexander Industries, Inc.*, 8 Storey 548, 58 Del. 548, 211 A.2d 919, 920 (1965).

Thus in the present case an intent to confer third party beneficiary status on Nemours must be gleaned from the language of the Gilbane–Pierce subcontract. The language of a contract, however, cannot be divorced from the context in which it was written. Here, we are dealing with a general contract and a subcontract in the construction industry.

Typically when major construction is involved an owner has neither the desire nor the ability to negotiate with and supervise the multitude of trades and skills required to complete a project. Consequently an owner will engage a general contractor. The general contractor will retain, coordinate and supervise subcontractors. The owner looks to the general contractor, not the subcontractors, both for performance of the total construction project and for any damages or other relief if there is a default in performance. Performance and

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3. The third party beneficiary issue, like the negligence issue, was presented to the trial court in the context of pretrial motions, motions during the trial, objections to the jury charge and post-trial motions.

the payment of damages are normally assured by the bond of a surety on which the general contractor is principal and the owner is the obligee.

The general contractor, in turn, who is responsible for the performance of the subcontractors, has a right of action against any subcontractor which defaults. Performance and payment of damages by a subcontractor are normally assured by the bond of a surety on which the subcontractor is principal and the general contractor is the obligee.

Thus the typical owner is insulated from the subcontractors both during the course of construction and during the pursuit of remedies in the event of a default. Conversely, the subcontractors are insulated from the owner. The owner deals with and, if necessary, sues the general contractor, and the general contractor deals with and, if necessary, sues the subcontractors.

These typical construction contract relationships have long been recognized:

> [Contracts between a principal building contractor and subcontractors] are made to enable the principal contractor to perform; and their performance by the subcontractor does not in itself discharge the principal contractor's duty to the owner with whom he has contracted. The installation of plumbing fixtures or the construction of cement floors by a subcontractor is not a discharge of the principal contractor's duty to the owner to deliver a finished building containing those items; and if after their installation the undelivered building is destroyed by fire, the principal contractor must replace them for the owner, even though he must pay the subcontractor in full and has no right that the latter shall replace them. It seems, therefore, that the

> owner has no right against the subcontractor, in the absence of clear words to the contrary. The owner is neither a creditor beneficiary nor a donee beneficiary; the benefit that he receives from performance must be regarded as merely incidental.
>
> A contractor entered into a contract with the Government, the latter promising to pay the cost plus a fixed fee and assenting to the letting of subcontracts. In such a case it is clear, in the absence of evidence of a different intention, that the subcontractor is not a beneficiary of the Government's promise to the contractor to pay the cost, even though the amount payable to the subcontractor is reckoned as part of the cost. The Government made no promise to pay anything to the subcontractors. For similar reasons, the Government is not a beneficiary of a subcontractor's promise to the contractor, even though the performance promised may enable the contractor to perform his contractual duty to the Government.

4 *Corbin on Contracts* § 779D (1951 ed.) at 46, 47.

These typical construction relationships are also recognized in Delaware law. In *Cannon* the Delaware Supreme Court referred to the "buffer zone" which a general contract creates between the owner and a subcontractor, although in that case it found that the language of the subcontract evidenced an intent to extinguish the buffer zone. 336 A.2d at 216.

There is nothing to prevent a departure from the typical pattern, and, as was the case in *Cannon*, a contractor and subcontractor may agree to confer upon an owner rights which are enforceable directly against the subcontractor. However, an intent to do so must be found in the contract documents. Thus in the present case it must be determined

whether the Gilbane–Pierce subcontract evidences an intent on the part of both Pierce and Gilbane to depart from the typical owner-general contractor and general contractor-subcontractor relationships to confer upon Nemours a direct right of action against Pierce.

The overall structure of the contractual relationships in this case falls into the traditional mold. Nemours as owner entered into a general contract with Gilbane. Gilbane's obligations were assured by a performance bond issued by Aetna. Gilbane entered into a number of subcontracts, including the one with Pierce. Each subcontractor's obligations were assured by a performance bond, a performance bond issued by Federal in the case of Pierce. If indeed Gilbane intended that the subcontract create an obligation running directly from Pierce to Nemours, it is curious that it accepted (in fact, prescribed) a performance bond which provided that no right of action would accrue on it to or for the use of any person other than Gilbane.

The language of the Gilbane–Pierce subcontract suggests that Gilbane and Pierce contemplated that Pierce was to be obligated to Gilbane, not to Nemours.

The subcontract is between Pierce, as subcontractor, and Gilbane as the contractor. Section 6 specified Gilbane as the entity to which Pierce was to be responsible: "The *Subcontractor* agrees to be bound to the *Contractor* by the terms and conditions of the Agreement . . . and to assume toward the *Contractor* all the obligations and responsibilities that the *Contractor*, by these documents, assumes toward the *Owner*." (Emphasis added.)

Section 7(f) of the subcontract provides that if Pierce fails to perform, Gilbane may provide labor, equipment or materials or may terminate Pierce and complete the work itself. Section 38E of the Special conditions provides that the *sub-*

contractor's payment and performance bond shall name *Gilbane* as obligee.

Exhibit A to the general contract, which of course is evidence of Gilbane's intent, provides that "[t]he *Contractor* shall have *sole* and *total responsibility* for completing the [general] contract . . . and is responsible to the *Owner* for the full, proper, and timely performance of all work under the contract." (Emphasis added.) Article 4.3.2 of the General Conditions provides that "[t]he *Contractor* shall be responsible to the *Owner* for the acts and omissions of his employees, *Subcontractors* and their agents and employees. . . ." (Emphasis added.)

Of significance is the incorporation of the standard AIA General Conditions of the Contract for Construction into both the general contract and the subcontract. Article 1.1.2 of the General Conditions provides:

> Nothing contained in the Contract Documents shall create any contractual relationship between the Owner or the Architect and any Subcontractor or Sub-subcontractor.

Nemours urges that in light of the definition of "Contract Documents" in Article 1.1.1, the Article 1.1.2 language serves only to preclude the general contract from creating a contractual relationship between Nemours as owner and Pierce as subcontractor but does not preclude the subcontract from creating such a relationship. Article 1.1.2 provides that "[n]othing contained in the *Contract Documents* shall create any contractual relationship between the Owner . . . and any Subcontractor. . . ." (Emphasis added.) As defined in Article 1.1.1, however, "Contract Documents" does not include the subcontract and, therefore, Nemours argues, there is no prohibition against the subcontract creating a third party beneficiary relationship between Nemours and Pierce.

If the Article 1.1.2 language appeared only in the general contract, Nemours' argument might be persuasive. However, there was repeated incorporation of the General Conditions and its Article 1.1.2 language into the subcontract.

At page 1A of the subcontract it is provided that all work thereunder shall be in accordance with "General Conditions of the Contract for Construction, in (sic) Specifications, (AIA Document A201—1976 Edition)". In Section 6, referred to above, Pierce as subcontractor agrees to be bound by the General Contract and the General Conditions for Construction. Section 7(g) provides that "[t]he Terms and Provisions herein contained and the General Conditions For Construction (AIA Document A201—1976 Edition)... shall supersede all previous communications, representations, or agreements, either oral or written, between the parties hereto with respect to the subject matter hereof."

This repeated incorporation of the General Conditions and its Article 1.1.2 no contractual relationship language is a strong indication of an intent on Gilbane's and Pierce's part to maintain the separate owner-general contractor and general contractor-subcontractor relationships.

No Delaware court appears to have construed general contracts or subcontracts which contain Article 1.1.2 of the AIA General Conditions or comparable language. Decisions in other jurisdictions, however, have held that this provision (or like language) prevents an owner from maintaining a breach of contract action against a subcontractor on a third party beneficiary theory, or prevents a subcontractor from maintaining a breach of contract action against an owner on such a theory. Thus the buffer is preserved by Article 1.1.2 or its equivalent. *E.C. Ernst, Inc. v. Manhattan Constr. Co. of Texas*, 551 F.2d 1026 (5th Cir.1977), *cert. denied*, 434 U.S. 1067, 98 S.Ct. 1246, 55 L.Ed.2d 769 (1978) (subcontractor asserted it was a third party beneficiary under the general contract); *Honey v. George Hyman Construction Co.*, 63 F.R.D. 443

(D.D.C.1974) (insurer subrogated to rights of owner asserted it was a third party beneficiary of the subcontract between the general contractor and the subcontractor); *Federal Mogul Corp. v. Universal Constr. Co.*, 376 So.2d 716 (Ala.Civ.App.1979), *cert. denied*, 376 So.2d 726 (Ala.1979) (owner sought to recover from a subcontractor on a third party beneficiary theory).

In *Honey* the general contract included a General Condition which provided that "[n]othing contained in the specifications or drawings shall be construed as creating any contractual relationship between any subcontractor and the Owner." The General Condition did not specifically preclude a subcontract from creating a contractual relationship between owner and subcontractor, but the court held nevertheless that incorporation of the General Condition by reference in the subcontract "clearly indicates that [the subcontractor] intended to avoid any contractual obligation to [the owner]." 63 F.R.D. at 450.

Similarly in *Federal Mogul Corp.* the general contract included a General Condition of the Contract for Construction which provided that "[n]othing contained in the contract documents shall create any contractual relation between any subcontractors and the owners." Here too the General Condition did not specifically preclude a subcontract from creating a contractual relationship between owner and subcontractor, but again the court held that by virtue of its incorporation in the subcontract "the language of the instant documents expressly pre-empts the creation of third party contract rights in [the owner]." 376 So.2d at 724. *See also* dicta in *G & P Electric Co. v. Dumont Construction Co.*, 194 Cal.App.2d 868, 15 Cal.Rptr. 757, 763 (1961).

Nemours' principal argument in support of its third party beneficiary theory is that the Gilbane–Pierce subcontract contains numerous provisions which evidence an intent that Nemours be benefited by Pierce's performance. The descrip-

tion of Pierce's work in Section 1 provides that it shall be subject to the supervision and satisfaction of the contractor and the owner. There are a number of other provisions which impose obligations on Pierce vis-a-vis Nemours, such as an obligation to furnish Shop Drawings, Erection Drawings, etc. for Nemours' approval, the requirement that Pierce indemnify and save harmless Nemours from any expense, liability or loss arising from patent, copyright or trademark infringement.

In every construction subcontract the owner is the one which ultimately benefits from its performance. However, this does not create a third party beneficiary relationship.

Nemours relies heavily on *Oliver B. Cannon & Sons, Inc. v. Dorr–Oliver, Inc., supra*, in which the court held that in the circumstances of that case the various provisions of the subcontract benefiting the owner demonstrated an intent by the parties to the subcontract that the owner be a third party beneficary of the subcontract. The result in that case turned on the ascertainment of the parties' intent. What distinguishes the present case from *Cannon* is Pierce's and Gilbane's expressed intent that there be no third party beneficiary relationship between Pierce and Nemours. For the same reason *Sears, Roebuck and Co. v. Jardel Co.*, 421 F.2d 1048 (3d Cir.1970) (applying Pennsylvania substantive law) is inapplicable.

Until the execution of the settlement agreement between Nemours and Gilbane, the actions of all three parties affirmed the absence of a contractual relationship between subcontractor and owner. In its September 9, 1980 letter to Gilbane approving the Gilbane–Pierce subcontract, Nemours wrote "nothing herein shall be deemed or construed to create any contractual relationship between The Nemours Foundation and said subcontractor [Pierce]." During the period when disputes about performance of the contract had developed Nemours looked to Gilbane and Gilbane alone with respect to

completion of Pierce's work under the subcontract. The manner in which the contract litigation was instituted and initially prosecuted and defended evidenced the understanding of Nemours, Gilbane and Pierce that no contractual relationship existed between Nemours and Pierce.

We conclude that the subcontract does not manifest an intent by Pierce and Gilbane to confer third party beneficiary status upon Nemours. In fact, the subcontract evidences an intent to preclude such a status. Nemours and Gilbane were but two of three parties in a relationship carefully structured by contract (the general contract and the subcontract). Pierce was the third party in that relationship. By means of the settlement agreement Nemours and Gilbane, in effect, sought to change that relationship to give Nemours a previously nonexistent direct cause of action against Pierce. Without Pierce's participation that was not possible. Contractual rights cannot be so casually disregarded.

Thus to the extent that the judgment of the trial court rests upon Nemours' third party beneficiary claim it must be reversed.

IV. *Negligence Claim*

Nemours sued Pierce on a negligence theory as well as on a third party beneficiary theory. The trial court instructed the jury that "If you find that Pierce was negligent and that its negligence was the proximate cause of the damages allegedly sustained by Nemours, you should award Nemours an amount that will fairly and adequately compensate it for such damage." Negligence was defined for the jury as Pierce's breach of "its duties to perform its work on the hospital project in a reasonable, careful and workmanlike manner" by ten specified acts or failures to act, such as failing to supply necessary manpower, failing to perform work in a careful and workmanlike manner, failing to submit necessary documentation, failing to properly schedule work, etc. The jury was told that the elements of damages on the negligence claim

were (i) the cost of correcting or replacing alleged defective or non-conforming work installed by Pierce, (ii) the cost of completing the work left incomplete by Pierce, (iii) the extra cost of construction paid to other subcontractors as a result of the alleged breaches of contract by Pierce, and (iv) the cost of obtaining as-built drawings of Pierce's subcontract work. The jury found against Pierce on Nemours' negligence claim and the judgment awarded Nemours the same sum on account of both its contract and negligence claims—$13,040,910 plus pre-judgment and post-judgment interest.

On appeal Pierce contends that the trial court erred in failing to dismiss Nemours' negligence claim and allowing it to go to the jury. Pierce contends that under Delaware law, absent privity of contract, a party may not maintain a cause of action sounding in negligence to recover for purely economic loss, citing as authority the Delaware Superior Court case of *Crowell Corp. v. Topkis Construction Co.*, 280 A.2d 730 (Del.Super.1971).

Nemours asserts that this issue has been raised for the first time on appeal. That is clearly not correct. Like the contentions of other parties in this case, Pierce's legal contentions have shifted from time to time, depending on the exigencies of the moment. However, Pierce raised the negligence issue in its March 1984 motion to dismiss the negligence claim, and it preserved the issue as a defense in the Final Pretrial order.

In 1985 in the context, perhaps ironically, of Nemours' motion to dismiss Pierce's counterclaim based on negligence the district court concluded that the Delaware Supreme Court would probably not follow *Crowell* and would "abandon privity as a prerequisite to bringing suit on a negligence theory to recover financial losses suffered in the construction context." *Gilbane Bldg. Co. v. Nemours Foundation*, 606 F.Supp. 995, 1005 (D.Del.1985). There have been significant developments in the law on this issue since the date of the *Gilbane*

decision, and we arrive at a different conclusion from that of the district court.

No party in the present case disputes that Nemours' losses are purely economic and do not involve property damage or personal injury. It is necessary to decide whether the Delaware Supreme Court would follow the *Crowell* ruling that absent privity of contract a party may not recover in negligence for economic loss. Review on this issue is plenary.

Our role in this case is predictive. We must accord proper regard to decisions of intermediate state courts, but they are not conclusive. *Aloe Coal Co. v. Clark Equipment Co.*, 816 F.2d 110, 118 (3d Cir.), *cert. denied*, ___ U.S. ___, 108 S.Ct. 156, 98 L.Ed.2d 111 (1987).

In *Crowell*, decided in 1971, the owner of a building brought suit against an architect, a general contractor, and various subcontractors for damages arising from alleged construction defects in the building. The owner had no direct contractual relationship with the subcontractors, but sued them in tort "on allegations that they negligently breached the provisions of their contract with the general contractor and failed to do a workmanlike job thereby creating a defective building which was dangerous." The owner did not claim that the alleged negligence caused any accident, collapse or personal injury. Instead, the only damages the owner sought were its costs to correct the alleged construction defects.

Judge (now Chief Justice) Christie granted the subcontractors' motions for summary judgment, holding that "[t]he great weight of authority does not yet permit tort recovery under the circumstances here present in the absence of physical injury to a person or dramatic incident such as accident, collapse or explosion." *Id.* at 732. The court agreed with the subcontractors' contention that the owner should look to the general contractor for recovery of its alleged pecuniary loss. *Id.* at 731.

After *Crowell*, but still in the 1970's, two Delaware Supreme Court decisions in the construction setting allowed recovery of losses on a negligence theory. *Oliver B. Cannon & Son, Inc. v. Dorr–Oliver, Inc.*, 336 A.2d 211 (Del.1975); *Seiler v. Levitz Furniture Co.*, 367 A.2d 999 (Del.1976). Both of those cases, however, involved (i) property damage, not merely economic loss and (ii) privity of contract between the injured party and the wrongdoer.

In *Oliver B. Cannon & Sons, Inc. v. Dorr–Oliver, Inc.*, *supra*, the Delaware Supreme Court held that the owner (Barcroft) was a third party beneficiary of the subcontract, thus making that case clearly distinguishable from *Crowell*:

> The decision as to Barcroft's status and its privity of contract obviates the need to consider arguments of the parties relating to *Crowell Corporation v. Topkis Construction Co.*, Del.Super., 280 A.2d 730 (1971). In ruling against the maintenance of a tort action there, the *Crowell* court found no contractual relationship between owner and subcontractor.

336 A.2d at 216 n. 6. Moreover, the trial court opinion in *Oliver B. Cannon* emphasized that "[t]his is a case of *physical injury to property and not mere economic loss*." 312 A.2d 322, 329 (Del.1973). (Emphasis added.)

Similarly, in *Seiler v. Levitz Furniture Co.*, *supra*, the Delaware Supreme Court allowed a recovery in negligence by a shopping center tenant against an architect because the tenant's store suffered property damage during two major floods (367 A.2d at 1003-4), and also because the architect was liable to the tenant "under third-party beneficiary principles." *Id.* at 1007.

Recent developments in the law suggest a trend to preclude the maintenance of a negligence action to recover purely economic loss. In *East River S.S. Corp. v. Transamerica*

Delaval, Inc., 476 U.S. 858, 106 S.Ct. 2295, 90 L.Ed.2d 865 (1986), the Supreme Court held that "whether stated in negligence or strict liability, no products-liability claim lies in admiralty when the only injury claimed is economic loss." 476 U.S. at 876, 106 S.Ct. at 2305.

In *Aloe Coal Co.*, this court had to determine if the purchaser of industrial equipment damaged by a sudden fire could recover from the vendor on a negligence theory under Pennsylvania law. Despite the fact that two pre-*East River* decisions of a Pennsylvania intermediate appellate court might have allowed recovery in such circumstances, this court concluded that the Pennsylvania Supreme Court would follow the holding in *East River*.

> We understand completely that the *East River* holding is not binding on Pennsylvania courts, because the Supreme Court's decision was based on an interpretation of federal admiralty law only. The United States Supreme Court is supreme in matters of federal law; the Pennsylvania Supreme Court is supreme in matters of Pennsylvania law. Nevertheless, we conclude that the United States Supreme Court's analysis is so persuasive that it will be followed by Pennsylvania courts.

Id. at 117.

There is even stronger reason to believe that the Delaware Supreme Court will follow *East River's* analysis. In *Crowell* the Delaware Superior Court's ruling foreshadowed the *East River* holding. Neither Delaware Supreme Court case which allowed recovery of economic loss in the construction setting on a negligence theory is inconsistent with the rationale of *East River*, since each involved property damage and privity of contract.

For these reasons we predict that the Delaware Supreme

Court would, if the issue were raised, reaffirm the *Crowell* ruling as Delaware law. Consequently the district court in the present case erred in failing to dismiss Nemours' negligence claim and in presenting it to the jury.

V. *Consequences of Contract and Negligence Determinations*

We have concluded that under Delaware law Nemours has neither a third party beneficiary claim nor a negligence claim against Pierce. As a result, paragraph 1 of the final judgment which awards Nemours $19,045,982 plus post-judgment interest against Pierce must be reversed. This determination governs the disposition of certain other issues on these appeals.

Paragraph 1 of the final judgment also awards Nemours a similar recovery against Pierce's surety, Federal. Since Federal's liability to Nemours, if any, is completely derivative of Pierce's liability, the conclusion that Pierce is not liable to Nemours on a contract or tort theory relieves Federal of liability to Nemours.[4]

The performance bond issued by Federal which named Pierce as principal and Gilbane as sole obligee provided as follows:

> No right of action shall accrue on this bond to or for the use of any person or corporation other than

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4. This conclusion is consistent with this court's opinion in *Knecht, Inc. v. United Pacific Insurance Company*, 860 F.2d 74 (3d Cir.1988). Recognizing the general rule that the liability of a surety ends with the extinguishment of the obligation of its principal, we there held that notwithstanding the non-liability of the principal to the claimant which sued on the bond in that case, the particular language "created an independent liability to claimants as defined in the bond." By way of contrast, the language of Federal's performance bond expressly limited the persons entitled to bring suit under it: "No right of action shall accrue on this bond to or for the use of any person or corporation other than the Obligee named herein [Gilbane] or the heirs, executors, administrators or successors of the Obligee."

> the Obligee named herein or the heirs, executors administrators or successors of the Obligee.

Federal argues persuasively on this appeal that the district court erred by holding that even in the face of this language Nemours was an intended third party beneficiary of the bond with enforceable rights thereunder. *See, for example, Rush Presbyterian St. Luke's Med. Center v. Safeco, Ins.*, 825 F.2d 1204 (7th Cir.1987). It would follow, Federal contends, that even if Pierce were held liable to Nemours on a third party beneficiary or negligence theory, Federal would not be liable to Nemours on the bond. However, in view of our finding with respect to Pierce's liability to Nemours, it is unnecessary to decide this issue.

Pierce and Federal contend that the jury's compensatory damage award was against the weight of the evidence and contrary to the trial court's instructions in that the award represented the exact amount which Nemours claimed for completion costs and failed to give Pierce any credit for its unpaid contract balance. Since the award in its entirety will be set aside, this contention need not be addressed.

During the trial Pierce offered as an expert witness its President and majority shareholder, Lewis Pierce. His expert testimony would have been directed to the issue of the reasonableness of Nemours' cost of completing the mechanical work. Nemours objected to this testimony, asserting that Mr. Pierce could not "qualify as an expert under the Federal Rules because he is so biased, so partial." The court sustained the objection on that ground, although later in the proceedings the court noted that Mr. Pierce "would not be of assistance to the trier of fact . . . and any probative value would be outweighed given his position as a principal." This ruling is troublesome whether it is viewed as a holding that Mr. Pierce, because of his position as a principal, was not qualified to testify or whether it is viewed as an exercise of discretion

under Evid. Rule 403. Again, in view of our previous determinations, it is not necessary to decide this question.

Paragraph 3 of the final judgment awards Nemours $1,000,000 in punitive damages against Pierce plus post-judgment interest. In view of our rulings on the liability issues, this award must be reversed.

In addition to punitive damages Paragraph 4 of the final judgment awards Nemours $1,042,311 for attorneys' fees and expert witnesses' and consultants' costs against Pierce plus post-judgment interest. Our rulings on the liability issues require that this award be reversed. Further, in a diversity case state law ordinarily governs the award of attorneys' fees. *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 259 n. 31, 95 S.Ct. 1612, 1622 n. 31, 44 L.Ed.2d 141 (1975). We discern nothing in Delaware law which would permit recovery of attorneys' fees in the circumstances of this case. *Stephenson v. Capano Development, Inc.*, 462 A.2d 1069 (Del.1983); *Casson v. Nationwide Ins. Co.*, 455 A.2d 361 (Del.Super. 1982). Even though this is a diversity case, the recovery of fees which a prevailing party pays to its expert witnesses and consultants is governed by federal law, namely, 28 U.S.C. §§ 1821 and 1920. *Dominic v. Hess Oil V.I. Corp.*, 841 F.2d 513, 517 (3d Cir.1988). The award of expert witness fees in this case was in excess of the amounts permitted by the statute.

VI. *The Indemnity Claim*

Under the March 1985 settlement between Nemours and Gilbane, Nemours, in addition to other undertakings, agreed to pay Gilbane the sum of $3,375,000. Using this money in addition to settlement funds received from the architect and the engineer, Gilbane then paid the aggregate sum of $3.669 million to settle the delay claims asserted by Dynalectric, Honeywell and other subcontractors. After these payments were received the subcontractors dismissed their

claims against Gilbane and their cross-claims against Nemours. In its amended complaint filed following consolidation, Nemours sought indemnification from Pierce for the monies it paid to Gilbane and the jury ultimately awarded it the full settlement sum plus $1,554,118 in pre-judgment interest.

The parties dispute the precise purpose of the settlement payments Nemours made to Gilbane. Pierce claims that the money was paid to settle the subcontractors' delay claims against Nemours. Nemours claims that if the payment did not reflect direct liability to the subcontractors, it reflected Nemours' liability to Gilbane for the subcontractors' claims against the latter.[5] Under either rationale, however, the claim

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5. The record clearly supports Pierce's position that at trial Nemours pursued its indemnity claim on the theory that it was potentially liable to the subcontractors (not to Gilbane) as a result of delays allegedly caused by Pierce. For example, the court's charge to the jury on the Nemours indemnity claim was as follows:

> If two parties are liable to a third party for the same harm, and one of these pays the third party the full amount of the damages, then that party may claim indemnity against the other party. In an indemnity action, the party that paid the damages claims that the other party was liable for the injuries to the third party, and is required to reimburse the paying party for the full amount of the damages that were paid to the third party. In this case the owner, Nemours, is claiming indemnity against a subcontractor, Pierce, for the full amount of the damages *paid through the general contractor, Gilbane, to the other subcontractors* on the Hospital project.
>
> To recover on a claim of indemnity, Nemours must prove by a preponderance of the evidence the following:
>
> One, that subcontractors other than Pierce actually incurred the damages for which Pierce paid.
>
> *Two, that Nemours was legally liable to other subcontractors for the damages they incurred.*
>
> *Three, that Nemours had a duty to pay the other subcontractors' damages.*
>
> Four, that the active conduct of Pierce caused the damages to the other subcontractors.
>
> Five, that no active conduct or wrongdoing by Nemours contrib-

for indemnity is legally insufficient and must therefore be reversed. Our review of this issue is plenary.

A right to indemnity may arise through a contractual agreement, express or implied. *See Oliver B. Cannon & Son, Inc. v. Dorr–Oliver, Inc.*, 394 A.2d 1160, 1165 (Del.1978) (express right of indemnity); *Diamond State Telephone Co. v. University of Del.*, 269 A.2d 52, 56–59 (Del.1970) (express and implied rights of indemnity). When required by the equities of a given situation, some courts will also imply a right of indemnity wholly independent of any contractual relationship. *Diamond State, supra*, 394 A.2d at 56; *Cumberbatch v. Board of Trustees*, 382 A.2d 1383, 1389 (Del.Super. 1978).[6]

It is not readily apparent under which theory of indemnity Nemours' claim was presented to the jury. This is clearly not a case where there was an explicit indemnity provision in ~~the~~ contractual agreements between Nemours and Gilbane or Gilbane and any of the various subcontractors. If a right of indemnity exists, therefore, it must be implied in contract or in equity.

The Delaware courts stand ready, in the proper case, to imply a contractual duty of due care and a concomitant promise of indemnification upon third-party contractors or third-party employers when owners or manufacturers seek indemnity from them after the owners or manufacturers have been

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uted to the damages to the other subcontractors.

Six, that Pierce was under a legal duty to Nemours to indemnify it for the amounts paid to other subcontractors.

And, lastly, that the amount paid to the other subcontractors was reasonable.

(Emphasis added.)

6. Under Delaware law, a right to contribution (and not indemnity) exists between joint tort-feasors. *Diamond State, supra*, 269 A.2d at 56. As the discussion in Section IV, *supra*, demonstrates, Nemours could not be liable to either Gilbane or any of the subcontractors in tort because Delaware would not recognize a tort claim for mere economic loss.

sued by injured employees. *See Diamond State, supra*, 269 A.2d at 56-57; *Howard, Needles, Tammen & Bergendoff v. Steers, Perini & Pomeroy*, 312 A.2d 621, 623 (Del.1973); *SW (Delaware), Inc. v. American Consumers Indus., Inc.*, 450 A.2d 887 (Del.1982). This use of implied contracts permits indemnity where it would not otherwise be available because of the exclusivity of the worker's compensation remedy.

It is somewhat unclear whether Delaware would apply this theory of indemnity by implied contract to a case that does not involve the possible injustice of the worker's compensation bar. Even if the Delaware courts were to expand the doctrine, an implied contract could not be found here.

Nemours claims that it is entitled to indemnification on two possible grounds. Nemours claims first, in essence, that since it was required to indemnify Gilbane for the claims brought against Gilbane by the subcontractors for the delays caused by Pierce, it is entitled to indemnification by Pierce. Alternatively, Nemours claims that it is entitled to indemnity against Pierce for the claims brought directly against Nemours by the subcontractors for Pierce's delays.

Both of these theories assume that Nemours is responsible, ultimately, for Pierce's breach of contract and require the implication of a duty and promise of indemnity running directly from Pierce to Nemours. For the reasons discussed below, Nemours is not liable to Gilbane or to the subcontractors directly, for the claims asserted by the subcontractors for the delays caused by Pierce. Even if it were, however, it is clear that there can be no implied contract between Nemours and Pierce that would require the latter to indemnify the former. As we concluded above, Nemours is not a third-party beneficiary of the Gilbane–Pierce subcontract. And, as the inclusion by reference in the latter agreement of Article 1.1.2 of the Nemours–Gilbane contract makes clear, no contractual relationship whatever was intended between Pierce and Nemours. To imply what was expressly precluded would con-

tort the plain meaning of the contract's language and subvert the intent of the parties.

Section 7(e) of the Gilbane–Pierce subcontract provides that Pierce will "indemnify and save harmless" Nemours from any expenses, liabilities or losses arising from patent, copyright or trademark infringement. Obviously, this provision does not apply in the present factual context. In a similar situation, moreover, the Delaware Supreme Court ruled that a limited indemnity agreement between two parties could not be expanded by implication to indemnify a third-party. In *Howard, Needles, supra*, a contractor attempted to use the indemnity provisions between the owner and another contractor to secure indemnity from the latter. The court wrote that "when the parties to a contract have entered into a written agreement, expressly setting forth one party's indemnity liability, there is no room for any enlargement of that obligation by implication." *Howard, Needles, supra*, 312 A.2d at 624.

If there is no implied contractual right of indemnity, it must be determined whether Nemours may have an implied equitable right of indemnity. Although no Delaware case has applied it, Delaware courts do apparently recognize implied equitable indemnification. *Diamond State, supra*, 292 A.2d at 56; *Cumberbatch, supra*, 382 A.2d at 1389. This doctrine, however, has been exclusively associated with Restatement of Restitution section 95 relating to "person[s] responsible for a dangerous condition," not a theory of liability applicable in the present case.

Courts in other jurisdictions have applied a more expansive doctrine which essentially dispenses with the need to show an express or implied contractual promise of indemnity when the equities of a given situation require it. As the frequently invoked maxim that equitable indemnity is not available to a "volunteer" demonstrates, however, there is a requirement that the payor have some actual or potential

liability for the obligation it discharges on another's behalf. *E.g., Aetna Life & Cas. Co. v. Ford Motor Co.*, 50 Cal.App.3d 52, 122 Cal.Rptr. 852, 854 (1975), Restatement of Restitution sections 76, 112 (1937). Some cases, pushing the doctrine even further, require only a "reasonable good faith belief" that the payor was "protecting his own interests" when he made the payment. *Hydro-Air Equip., Inc. v. Hyatt Corp.*, 852 F.2d 403, 407 (9th Cir.1988).

It is difficult to divine whether the Delaware Supreme Court would countenance an expansion of its relatively limited version of the doctrine. If it did, however, its brief discussion of the doctrine indicates that it would probably limit its availability to a payor who is "jointly liable" with the indemnitee. *See Diamond Telephone, supra*, 292 A.2d at 56.

Assuming without deciding that Delaware might apply an expanded doctrine, Nemours could not benefit from it because Nemours is simply not liable to the other subcontractors or to Gilbane for the delays caused by Pierce. Article 4.3.2 of the Nemours–Gilbane contract demonstrates that Nemours did not intend to indemnify Gilbane or otherwise accept liability for the claims brought by subcontractors against Gilbane for another subcontractor's breach of its contract with Gilbane. That provision states that "[t]he contractor shall be responsible to the owner for the acts and omissions of his employees, subcontractors and their agents and their employees . . ." To imply that Gilbane had a right of indemnity against Nemours or that Nemours was otherwise responsible for the claims brought against Gilbane for Pierce's delays would invert this language.

It is also clear that the subcontractors are not third-party beneficiaries of the Nemours–Gilbane contract since they are incidental and not intended beneficiaries. As discussed in Section III, *supra*, Article 1.1.2 of the General Conditions provides that "[n]othing contained in the Contract Documents shall create *any contractual relationship* between the Owner

and the Architect or any Subcontractor or Sub-subcontractor." (Emphasis added.) The subcontractors could not, therefore, claim against Nemours for Pierce's delay.

When Nemours settled the claims for Pierce's delay, whether with Gilbane or directly with the other subcontractors, it acted as a mere volunteer insofar as the subcontractors' claims were concerned. The subcontractors could not maintain an action against Nemours and Nemours was not liable to Gilbane for Pierce's delays. The proper route was for the subcontractors to seek damages from Gilbane which could then seek damages of Pierce.

For these reasons, therefore, that portion of the judgment reflecting Nemours indemnity claim against Pierce, along with interest, is reversed.

VII. *Gilbane's Contract Claim*

Gilbane asserted a claim against Pierce for breach of contract and a parallel claim against Federal on Federal's bond securing Pierce's performance of its work under the subcontract. Gilbane's breach of contract claim has two elements—(i) liquidated damages for delay in the amount of $3,000 for each day of delay from March 23, 1983 through December 4, 1984, for a period of 625 days resulting in a total liquidated damages claim of $1,857,000 and (ii) back charges for clean-up, hoisting and miscellaneous items in the amount of $269,699. The jury returned a verdict of $2,066,699 on the combined claim and judgment was entered in that amount plus $951,671 in pre-judgment interest plus post-judgment interest. Of necessity the major portion of the award represented liquidated damages.

Pierce and Federal challenge the liquidated delay damages award on the ground that the provision for liquidated damages created a "pass through" obligation, triggered only if Gilbane became obligated to Nemours under a similar provision in the general contract. Since Gilbane was never

required to pay delay damages (or, in fact, any damages) to Nemours, Pierce and Federal contend that Pierce is not required to pay delay damages to Gilbane.

Once again it is necessary to turn to the applicable contracts.

Article 4.1 of the general contract between Nemours and Gilbane provided:

> The work to be performed under this Contract shall be commenced within five (5) days of the effective date of the Architect's notice to proceed and, subject to authorized adjustments, Substantial Completion shall be achieved not later than September 15, 1982.
>
> It is expressly agreed and understood that time is of the essence in this agreement and if the contractor fails to complete the work on or before the above specified date, or any extension thereof, authorized in writing by the Owner, the actual damages to the Owner due to such delay will be difficult or impossible to determine. Contractor therefore agrees to pay, in lieu of actual damages and not as a penalty, the sum of $3,000 for each and every calendar day of delay, which constitutes fixed, agreed and liquidated damages. The Owner may at its option deduct said sums from monies due the Contractor. Contractor will not be charged with liquidated damages for delays excused by the Owner pursuant to the terms of paragraph A-3 of Exhibit A.

Paragraph 14 of the subsequently executed Gilbane–Pierce subcontract contained a liquidated damages provision which provided:

> Since time is of essence in this project, and since it is difficult to determine the exact damage that *the*

> *Owner* will sustain by a delay in performance, it shall be agreed that in case of failure on the part of the Subcontractor to complete the work within the time fixed in the Contract by milestones or any extension thereof, the Subcontractor shall agree to pay to the General Contractor liquidated damages, *a maximum sum* of $3,000 for each calendar day of delay in the completion of work. It shall be understood and agreed that the General Contractor may, at his sole determination, make a prorata assessment of the maximum liquidated damages for each Subcontractor. (Emphasis added.)

We reject at the outset Pierce's and Federal's contention that since Gilbane has failed to establish actual damages caused by the delay in completion, paragraph 14 of the Gilbane–Pierce subcontract constitutes an unenforceable penalty provision. "The general rule in Delaware is that an enforceable liquidated damages provision is distinguishable from a penalty where two criteria are found to exist. First, the damages which the parties might reasonably anticipate to result from a breach must be difficult or impossible to prove accurately and second, the agreed upon sum must be reasonable." *Piccotti's Restaurant v. Gracie's, Inc.*, 1988 Del.Super. LEXIS 48, at 3 [1988 WL 15338 at 1] (Del.Super.1988). It can hardly be disputed that delay damages in the complex construction context of this case would be difficult or impossible to prove accurately. Given the amount of money and the extent of the work involved in the Nemours–Gilbane contract and in the Gilbane–Pierce subcontract, it cannot be said that $3,000 per day liquidated damages bears an unreasonable relation to the damages that might be expected to result from a breach.

Under Delaware law it is a defendant's burden to demonstrate unreasonableness, and the district court in this case could appropriately have concluded that Pierce and Federal failed to sustain that burden. Further, contrary to Pierce's and

Federal's contentions, under Delaware law damages are recoverable under a valid liquidated damages provision even though no actual damages are proven as a consequence of that breach. *Piccotti's*, *supra*, at 4 [1988 WL 15338 at 2].

A more difficult question in the present case is whether the liquidated damages clauses in the general contract and in the subcontract must be read in tandem, with the latter becoming operative only if liquidated damages are recovered under the former.

As noted above the Nemours–Gilbane general contract recited that "actual damages to the *Owner* [Nemours] due to . . . delay will be difficult or impossible to determine" and provided for liquidated damages in the amount of $3,000 per day of delay.

The language of the Gilbane–Pierce subcontract was somewhat different in nature. It did not provide that actual damages to *Gilbane* would be difficult or impossible to determine. Rather, it provided that "it is difficult to determine the exact damage that the *Owner* [Nemours] will sustain by a delay in performance." Further, the Gilbane–Pierce subcontract did not provide for fixed liquidated damages of $3,000 per day. Rather, it provided for liquidated damages in "a *maximum* sum of $3,000 for each calendar day of delay in the completion of work."

Thus, standing alone the provision in the subcontract is not really a true liquidated damages clause. It refers to the difficulty of establishing the damages of a non-party to the subcontract (Nemours), which will not be claiming damages under the subcontract, and it does not establish a fixed amount as liquidated damages, only a maximum amount. To establish the actual amount of liquidated damages under the subcontract reference must of necessity be made to something else.

The subcontract liquidated damages provision makes sense only if it is construed, as Pierce and Federal contend, as a pass-through obligation, providing that in the event a subcontractor caused delay in completing the project Nemours could collect $3,000 per day from Gilbane, which in turn could pass-through that obligation to the subcontractor. Read in this light, the subcontractor's statement that it is difficult to ascertain the exact damage to the "Owner" makes sense. Similarly the amount of liquidated damages can be ascertained, namely the amount which Nemours, the Owner, recovered against Gilbane. Since there was a $3,000 per day amount which Nemours could recover, Gilbane was fully protected by the $3,000 ceiling in the subcontract. This view of the meaning of the liquidated damages provision in the subcontract is consistent with the court's conclusion in *United States v. Henke Constr. Co.*, 157 F.2d 13 (8th Cir.1946).

In the present case Gilbane paid nothing to Nemours as liquidated damages. In fact Nemours and its architect and engineer paid $4,025,000 to Gilbane under the settlement agreement, a sum which Gilbane distributed among its subcontractors (other than Pierce) and itself. In these circumstances Gilbane was not entitled to recover delay damages. It can reasonably be assumed that in the jury's award to Gilbane of $2,066,699 there was included the sum of $269,699 representing Gilbane's claim under the subcontract for back charges. To that extent paragraph 5 of the final judgment will be affirmed. The balance of the award contained in paragraph 5 representing liquidated delay damages must be reversed.

VIII. *Interest Rulings*

The appeals raise questions concerning interest to be paid on the judgment: (i) whether all pre-judgment interest should be computed from April 18, 1983, the date when the jury found that Pierce breached its subcontract, (ii) whether post-judgment interest is payable on pre-judgment interest, and (iii) whether post-judgment interest should have been reduced from 10½% to 5.63%.

These questions are academic with respect to most of the awards contained in the final judgment. However, the award on account of Gilbane's claim for back charges survives and therefore the interest questions must be addressed.

A. *Date for computing pre-judgment interest:* The trial court imposed pre-judgment interest on each award commencing on April 18, 1983, the date the jury found that Pierce breached its subcontract. Gilbane contends that under Delaware law in a contract case interest accrues from the date of the breach. *Superior Tube Co. v. Delaware Aircraft Industries, Inc.*, 60 F.Supp. 573 (D.Del.1945), and that, therefore, the April 18, 1983 date was the correct date from which to compute pre-judgment interest.

We conclude otherwise and hold that Delaware law requires that pre-judgment interest be computed from the date of loss, which may or may not be the date of the breach of the contract. *Getty Oil Co. v. Catalytic, Inc.*, 509 A.2d 1123, 1128 (Del. Super.1986); *see also* the admiralty case, *Slater v. Texaco, Inc.*, 506 F.Supp. 1099 (D.Del.1981). The case will, therefore, be remanded so that the district court can determine the appropriate date from which pre-judgment interest should run on the award in favor of Gilbane in the amount of $269,699.

B. *Post-judgment interest on pre-judgment interest:* Pierce and Federal urge that it was error for the district court to award post-judgment interest on the pre-judgment interest awarded to Nemours and Gilbane. This contention is academic insofar as it relates to the awards in favor of Nemours. It may be incorrect as a matter of law insofar as it relates to the award in favor of Gilbane. *Summa Corp. v. Trans World Airlines, Inc.*, 540 A.2d 403, 410 (D.Del.1988). However, we conclude that the district court correctly refused to grant Pierce's and Federal's motion for relief from the interest award because it was filed too late.

More than a year and a half after judgment was entered

in this case Pierce and Federal filed a motion for relief from the award of so-called "compound interest." The district court denied the motion on the grounds that (i) it did not have jurisdiction because the case was pending before this court, (ii) the motion was not properly brought under Rule 60(a) as it did not involve a clerical error, and (iii) it was untimely under Rule 60(b)(1) as it was not filed within one year from the date of final judgment.

The motion was clearly untimely and Pierce and Federal advanced no sound reason in the district court why the court should exercise its discretion to relieve them from the final judgment's provisions imposing post-judgment interest on pre-judgment interest. Consequently the district court's order will be affirmed.

C. *Reduction of post-judgment interest rate:* Apparently unaware of the effect of 28 U.S.C. § 1961 concerning post-judgment interest on federal court judgments, Pierce and Federal agreed to inclusion in the final judgment of a 10½% post-judgment interest rate. On September 14, 1987, 364 days after entry of the final judgment, they moved pursuant to Fed.R. Civ.P. 60(b)(1) and 60(b)(6) seeking to have the district court change the post-judgment interest rate. Ultimately the district court granted the motion, reducing the post-judgment interest rate from 10½% to 5.63%.

The matter is governed by 28 U.S.C. § 1961 notwithstanding that this is a diversity action. Nemours and Gilbane appeal the district court's order granting Pierce's and Federal's motion on the ground that it was not timely brought.

A motion for relief under Rule 60(b) is directed to the sound discretion of the trial court. *Giordano v. McCartney*, 385 F.2d 154, 155 (3d Cir.1967). We do not find that the district court abused its discretion by entertaining the motion in the circumstances of this case. It is a particularly complex matter. The final judgment was entered with considerable

haste after the jury verdict, and at the time the Rule 60(b) motion was filed the district court still had not ruled on Pierce's and Federal's motions for new trial and for judgment notwithstanding the verdict.

A Rule 60(b)(1) motion must be filed within a reasonable time and in any event not more than one year after the judgment was entered. We cannot say that the district court abused its discretion when it found that the motion was filed within a reasonable time and considered it on the merits. For that reason the order granting the motion will be affirmed.

IX. *Conclusion*

Paragraph 1 of the final judgment which awards Nemours damages and interest against Pierce and Federal for Pierce's negligence and breach of contract will be reversed.

Paragraph 2 of the final judgment which awards Nemours damages and interest against Pierce for indemnity payments will be reversed.

Paragraphs 3 and 4 of the final judgment which award Nemours, respectively, punitive damages plus interest and attorneys' fees and consultants' costs plus interest will be reversed.

Paragraph 5 of the final judgment which awards Gilbane damages and interest against Pierce and Federal for Pierce's breach of contract will be modified as follows: The amount of the recovery before interest will be $269,699.22. Post-judgment interest (including interest on pre-judgment interest) will be computed at the rate of 5.63%. On remand the district court will ascertain the proper date or dates from which pre-judgment interest shall be computed (at the rate of 13½%).

Paragraph 6 of the final judgment will be modified to provide that each party shall bear its own costs.

SLOVITER, Circuit Judge, dissenting.

I.

Although I am in agreement with a substantial portion of the majority opinion in this complex appeal, I respectfully dissent because I disagree with the conclusion that under Delaware law the owner, Nemours, could not be considered to be a third party beneficiary of the subcontract for purposes of bringing suit for damages sustained when Pierce, the subcontractor, walked off the job. The effect of the majority's decision is that while Nemours had a substantial dispute with general contractor, Gilbane, over performance and payment, which resulted in litigation, Nemours was nonetheless required either to depend on Gilbane to file and process Nemours' claim for damages against Pierce or to sue Gilbane for what the jury found was Pierce's unjustifiable refusal to perform.

As the majority recognizes, this court sitting in diversity is bound to apply Delaware law. Because I believe that a fair reading of the applicable Delaware case law supports the inference that Pierce and Gilbane intended to benefit Nemours, I conclude that Nemours could maintain a third party beneficiary suit against Pierce.

The majority correctly points out that under Delaware law the right to sue on a contract as a third party beneficiary is a function of the contracting parties' intent to confer a benefit on the third party.[7] As I read Delaware case law, contractual provisions in a subcontract such as those in the

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7. The district court determined that Nemours was a third party beneficiary of the Gilbane–Pierce contract as a matter of law, and did not submit the issue of the parties' intent to the jury. The parties have not argued otherwise on this appeal. *But see STV Engineers, Inc. v. Greiner Engineering Inc.*, 861 F.2d 784 (3d Cir.1988) (Sloviter, dissenting) (question of the intent of contracting parties with respect to ambiguous term is issue of contract interpretation and hence a matter of fact).

Gilbane–Pierce subcontract are sufficient to permit an inference of intent to benefit the owner. *See Oliver B. Cannon & Sons, Inc. v. Dorr–Oliver, Inc.*, 336 A.2d 211, 215–16 (Del.1975); *Oliver B. Cannon & Sons, Inc. v. Dorr–Oliver*, 312 A.2d 322 (Del.Super.Ct.1973); *see also Sears, Roebuck and Co. v. Jardel*, 421 F.2d 1048 (3d Cir.1970) (applying Pennsylvania law but cited with approval by Delaware Supreme Court in *Cannon*).

Factors referred to in these cases as significant were that the subcontracts in question identified the owner, specified that work was to be done on the owner's premises, and contained provisions whereby the subcontractor undertook to indemnify the owner against certain losses arising out of the execution of the subcontractor's work. *Cannon*, 312 A.2d at 327–28 & nn. 4–5 (Del.Super.Ct.); *Jardel*, 421 F.2d at 1054 & nn. 18–19. Additionally the Delaware Supreme Court, in affirming the Superior Court's decision in *Cannon*, cited the existence of a warranty for defective workmanship running from the subcontractor to the owner. *Cannon*, 336 A.2d at 216 (Del.). Because the Gilbane–Pierce contract contains equivalent provisions, I believe that there was sufficient evidence under Delaware law to find that Gilbane and Pierce intended to make Nemours a beneficiary of the subcontract.

The majority declines to follow the *Cannon* courts' rationale on the grounds that there is other evidence which negates the inferences of intent which are permissible under those decisions. Majority at 539. To the extent the majority relies on evidence gleaned from sources other than the Gilbane-Pierce contract itself, such as statements by Nemours to the effect that there was no contractual relation between it and Pierce, the majority deviates from the acknowledged Delaware requirement that the intent to create a third party beneficiary must be ascertained from the language of the contract itself. *See Cannon*, 336 A.2d at 215 (Del.); *Royal Indemnity Co. v. Alexander Industries, Inc.*, 211 A.2d 919, 920 (Del.1965); *Crow v. Erectors Inc.*, 1988

Del.Super. LEXIS 18, 6 (Del.Super. 1988) [1988 WL 7617, p. 2].

The majority's conclusion that Pierce and Gilbane did not intend to benefit Nemours rests primarily on the incorporation of Article 1.1.2 of the AIA General Conditions of the Contract for Construction from the Nemours–Gilbane contract into the Gilbane–Pierce contract. That clause, which states that nothing contained in the "Contract Documents" shall create any contractual relationship between the Owner and a Subcontractor, clearly expresses Nemours' intent not to confer third party rights on *Pierce*. The "Contract Documents" as defined in the Nemours–Gilbane contract in which Article 1.1.2 is embedded do not include the Gilbane–Pierce contract; the Gilbane–Pierce contract does not expressly preclude the formation of contractual relations between Pierce and Nemours. I am willing to assume *arguendo* that the relationship established by the scheme of incorporated provisions precluded the Owner and Subcontractor from asserting contractual claims against each other arising in the ordinary course of the construction, such as claims for additional payment due or failure to follow the contract specifications, and required that such claims be funneled through the prime contractor. I believe, however, that Delaware would require a more explicit preclusion of Nemours' right to sue the subcontractor for total failure of performance than the mere inclusion of this standard clause in the form contract, particularly in light of the indemnity and warranty provisions in the Gilbane–Pierce contract that were designed to benefit Nemours. Therefore I would affirm the district court's ruling that this case could proceed to the jury on a third party beneficiary theory.

II.

Because I reach this conclusion, I must also consider the propriety of the district court's exclusion of the expert testimony of Lewis Pierce, president of the company, on the reasonableness of Nemours' completion costs. In light of its dis-

position, the majority does not reach this issue, although it expresses its concerns with that ruling.

The district court originally sustained the objection to Pierce's testimony on the ground that Pierce was disqualified under Fed.R.Evid. 702 because of his interest in the outcome of the litigation, and thereafter stated that it would exclude Pierce's expert testimony under Fed.R.Evid. 403, on the ground that the probative value of such testimony would be outweighed by its prejudice. The rationale of the latter ruling was the same as its rationale under Rule 702, i.e., that Pierce had too much motivation to lie and that the jury would attach too much weight to his testimony if he were labelled an expert.

Even under the deferential abuse of discretion standard applied to evidentiary rulings, I could not sustain the exclusion of Pierce's testimony. The district court found that Pierce was fully qualified as an expert. The Federal Rules of Evidence have greatly relaxed the standards for the admissibility of expert testimony. While the district court may have been relying on the prohibition against using witnesses who are paid on a contingent basis, *see Model Code of Professional Responsibility*, DR 7–109(C) (1980), the rule as applied by the district court would disqualify as experts all parties and many employees of parties, a position which has no support under current principles of evidence. *See Manufacturing Research Corp. v. Graybar Electric Co.*, 679 F.2d 1355, 1366 n. 21 (11th Cir.1982); *Dunn v. Sears, Roebuck & Co.*, 639 F.2d 1171, 1174 (5th Cir.), *modified on other grounds*, 645 F.2d 511 (1981).

Pierce's possible bias was merely a matter affecting credibility and went to the weight not the admissibility of the evidence. *See Universal Athletic Sales Co. v. American Gym, Recreational & Athletic Equipment Corp.*, 546 F.2d 530, 539–40 (3d Cir.1976) (error for trial judge sitting as trier of fact to accord too much weight to testimony given by lawyer

as expert witness on his client's behalf, but not error to permit lawyer to testify), *cert. denied*, 430 U.S. 984, 97 S.Ct. 1681, 52 L.Ed.2d 378 (1977).

Since Pierce was the last witness for the Company in an extremely lengthy trial, I cannot say that the exclusion did not affect the outcome of the trial. Pierce had little or no time to procure another expert, and was thus prevented from putting an important aspect of its case before the jury. The issue of completion costs was one on which expert testimony could assist the trier of fact because the court had permitted Nemours' expert to testify on that subject. The district court did permit Pierce to give lay opinion testimony under Fed.R.Evid. 701, but his opinion was limited to facts which he had actually perceived, and he was prevented from stating his opinion of the analysis of Nemours' completion costs as presented by their expert. Thus, I would view the exclusion as warranting a remand for a new trial.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

District Court Omnibus Order of March 15, 1984

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

GILBANE BUILDING COMPANY,
a Rhode Island corporation,

Plaintiff,

v.

THE NEMOURS FOUNDATION, a Florida corporation;
SAXELBYE, POWELL, ROBERTS & PONDER, INC.,
a Florida corporation; FURLOW ASSOCIATES, INC.,
a Pennsylvania corporation,

Defendants.

(Civil Action No. 83-192-JLL)

DYNALECTRIC COMPANY, a Florida corporation,

Plaintiff,

v.

GILBANE BUILDING COMPANY, a Rhode Island corporation,

Defendant and Third Party Plaintiff.

v.

THE NEMOURS FOUNDATION, a Florida corporation,
and SAXELBYE, POWELL, ROBERTS & PONDER, INC.,
a Florida corporation,
and
FURLOW ASSOCIATES, INC., a Pennsylvania corporation,

Third-Party Defendants.

(Civil Action No. 83-194-JLL)

PIERCE ASSOCIATES, INC., a Virginia corporation,

Plaintiff,

v.

GILBANE BUILDING COMPANY, a Rhode Island corporation,

Defendant and Third-Party Plaintiff.

v.

THE NEMOURS FOUNDATION, a Florida corporation,
and

SAXELBYE, POWELL, ROBERTS & PONDER, INC.,
a Florida corporation,
and
FURLOW ASSOCIATES, INC., a Pennsylvania corporation,
Third-Party Defendants.
(Civil Action No. 83-195-JLL)

ERNE2T DISABATINO & SONS, INC.,
Plaintiff,
v.
THE NEMOURS FOUNDATION,
Defendant.
(Civil Action No. 83-58-JLL)

OMNIBUS ORDER ON PENDING MOTIONS

These four consolidated cases concern complex claims, counterclaims and third-party claims asserted by and against the owner, architect, mechanical engineer, prime contractor and subcontractors who are all involved in the phased construction of certain additions to the Alfred I. duPont Institute Hospital located near Wilmington, Delaware. Essentially, each of the parties seek monetary damages from one or the other based on various legal theories by blaming the alleged delays experienced on the project as the fault of one or more of the other parties. A number of pending motions which have been briefed and orally argued are ready for decision. The Court having carefully considered the written submissions and oral arguments, it is

ORDERED:

1. The motion of The Nemours Foundation ("Nemours") filed in C.A. No. 83-192 for leave to file a Third Party Complaint against Ernest DiSabatino & Sons, Inc. ("DiSabatino"), and Fidelity and Deposit Company of Maryland ("F&D"), DiSabatino's surety, in the form and manner proposed

(Docket Item ["D. I."] 63), and the similar motion filed in C.A. No. 83-58 (D.I. 40) are hereby *granted.*

2. The motion of Nemours filed in C.A. No. 83-58 to join Fidelity & Deposit Co. of Maryland, surety for DiSabatino (D.I. 39), as a counterdefendant in the Nemours' counterclaim against DiSabatino is hereby *granted.*

Reasons for orders in pars. 1 and 2: No objections were made to such motions.

3. The motions (D.I. 95 in C.A. No. 83-192; D.I. 83 in C.A. No. 83-194 & D.I. 82 in C.A. No. 83-195) of Aetna Casualty and Surety Company ("Aetna") to dismiss (D.I. 84) (a) Nemours' counterclaim asserted against Aetna in C.A. No. 83-192 (D.I. 64), and (b) to dismiss Nemours' counterclaims asserted against Aetna in its Second Amended Answer and Counterclaim in C.A. No. 83-194 (D.I. 57) and in C.A. No. 83-195 (D.I. 56) are hereby *denied.* (D.I. 34 in C.A. No. 83-194 & D.I. 35 in C.A. No. 83-195.)

Reasons: Under its contract with Nemours, Gilbane Building Company ("Gilbane") executed with Aetna as its surety a labor and material payment bond and a performance bond, both of which named Nemours as the obligee. One of the purposes of these bonds was to insure that Gilbane's contract with Nemours would be performed in a proper and timely manner and that all labor and materials would be satisfied. Nemours in accordance with Rule 9(c) has sufficiently alleged the performance of conditions precedent to state a claim against Aetna under the bonds and to otherwise give adequate notice of Nemours' claims and their scope. Count I of the Second Amended Answer and Counterclaim recites the facts surrounding Gilbane's failures and refusal to perform its contractual obligations, and in Count III Nemours demands judgment against Aetna under the bonds for the full amount of all damages Nemours has allegedly incurred as a result of Gilbane's defaults. A reading of Nemours' pleadings

against Gilbane and Aetna are sufficient to avoid a motion to dismiss under Rule 12(b)(6), Fed.R.Civ.P.

4. The motion of Dynalectric Company ("Dynalectric") (D.I. 37) to dismiss Nemours' Count IV (breach of contract), Count V (negligence), Count VIII (fraud and willful breach), Count VI (against Travelers Insurance Company ["Travelers"], surety for Dynalectric), and to dismiss the claims for attorney fees in C.A. No. 83-194 from Nemours' Second Amended Answer and Counterclaim (D.I. 57) is hereby *denied*.

5. The motion of Pierce Associates, Inc. ("Pierce") (D.I. 37) to dismiss Nemours' Count IV (breach of contract), Count V (negligence), Count VIII (fraud and willful breach), Count VI (against Federal Insurance Company ["Federal"], surety for Pierce), and to dismiss the claim for attorney fees in C.A. No. 83-195 from Nemours' Second Amended Answer and Counterclaim (D.I. 56) is hereby *denied*.

6. The motions of Gilbane (D.I. 102) to dismiss Count III (fraud and willful breach) of Nemours' counterclaim against Gilbane in C.A. No. 83-192 and to dismiss Counts II and VII (D.I. 90 in C.A. No. 83-194 & D.I. 89 in C.A. No. 83-195) in Nemours' Second Amended Counterclaim against Gilbane in C.A. Nos. 83-194 and 83-195 and to dismiss the claims for attorney fees and for punitive damages in all three cases or, in the alternative, for a more definite statement are hereby *denied*.

Reasons for orders in pars. 4, 5 and 6 above: Dynalectric and Pierce argue that Count IV (breach of contract claims) in Nemours' Second Amended Counterclaim and Complaint should be dismissed because it did not sufficiently allege facts as distinguished from conclusions that Nemours is a third-party beneficiary to the Gilbane/Pierce and Dynalectric contracts. The Court disagrees. Nemours has sufficiently stated a cause of action against Dynalectric and Pierce to withstand a Rule 12(b)(6) motion. Furthermore, a consideration of the

contracts between Gilbane, Pierce and Dynalectric indicates that Nemours was an intended beneficiary of those agreements and Count III also provides sufficient notice of the nonperformance of the contractual obligations of Pierce and Dynalectric.

With respect to the negligence counts asserted against Gilbane (Count II in C.A. No. 83-192) and against Pierce and Dynalectric (Count V in C.A. Nos. 83-194 & 83-195), the Court finds that under Delaware law these allegations are not dismissable at this stage. Under Delaware law there is inherent in every building contract an implied undertaking that the work will be performed in a reasonable, careful and workmanlike manner and for breach of such implied duties, the injured party to the contract, at his election, may recover either in contract or tort but not both. Since alternative claims may be asserted under the Fed.R.Civ.P., this will not result in dismissal but if the matter goes to trial recovery can be had only on one or the other theories.

Nemours alleges fraud and bad faith against Gilbane in Count III in C.A. No. 83-192 and against Pierce and Dynalectric in Count VII in C.A. Nos. 83-194 and 83-195. The surrounding circumstances are sufficiently pleaded to give notice and to permit a response. If additional facts are needed they can be developed on discovery.

Finally, Gilbane, Pierce and Dynalectric move to strike the claims for punitive damages and attorneys' fees. There are sufficient allegations of bad faith and malice contained in Nemours' pleadings for these claims to remain in these cases. This does not mean that following trial these elements of damages would be awarded; it would depend upon proof developed at trial on the issue of bad faith and maliciousness.

7. Nemours' motion to join Travelers in C.A. No. 83-194, surety for Dynalectric, as a codefendant in the claims of Nemours against Dynalectric is hereby *granted*.

8. Nemours' motion to join Federal in C.A. No. 83-195, surety for Pierce, as a codefendant in Nemours' claims against Pierce is hereby *granted.*

Reason for orders in pars. 7 and 8: Nemours is an intended third-party beneficiary to the payment and performance bonds executed by Travelers and Federal on behalf of their principals Dynalectric and Pierce. Sufficient facts are alleged to indicate that the principals have failed to perform their obligations and the sureties were so notified. They should be brought in as parties to this litigation to avoid multiplicity of suits.

9. Nemours' motions to strike the documents entitled "Gilbane's counterclaim against Nemours by reply to counterclaim of Nemours" (D.I. 106 in C.A. No. 83-192; D.I. 95 in C.A. No. 83-194; D.I. 96 in C.A. No. 83-195) are hereby *granted.*

Reason: These documents are surplusage.

Dated: March 15, 1984.

/s/ JAMES L. LATCHUM

United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

GILBANE BUILDING COMPANY,
Plaintiff,

v.

The NEMOURS FOUNDATION, et al.,
Defendants.

Civ. A. No. 83—58—WKS.

March 25, 1985.

OPINION

STAPLETON, Chief Judge:

Before me is one portion of a consolidated action arising out of the construction of an 830,000 square foot addition to the Alfred I. duPont Institute Children's Hospital in Wilmington, Delaware (the "Project"). Contractual disputes and delays in completing the Project have spawned a complex and entangled thicket of litigation involving numerous parties and millions of dollars in claims. Since the factual background of the case has been set forth in some detail in prior opinions, *see, e.g., Gilbane Building Co. v. Nemours Foundation*, 568 F.Supp. 1085 (D.Del. 1983), repetition here is unnecessary. However, certain portions of this background must be highlighted in order to provide a factual backdrop for the discussion contained herein.

BACKGROUND

On April 5, 1983, Pierce Associates, Inc. ("Pierce") and Dynalectric Company ("Dynalectric") filed "sister" breach of contract actions against Gilbane Building Company ("Gilbane"). Gilbane had been retained by the Nemours Foundation ("Nemours"), the owner of the Project, to serve as the prime contractor during Phase 5B of the Project. Pierce and Dynalectric had both entered into subcontracts with Gilbane

to perform portions of the work scheduled for completion during Phase 5B. It was the alleged breach of these contracts by Gilbane which provided the genesis for the suits by Pierce and Dynalectric.

In response to the initiation of these breach of contract actions, Gilbane filed counterclaims against Pierce and Dynalectric and third-party complaints against Nemours, Saxelbye, Powell, Roberts & Ponder, Inc. ("Saxelbye"), the architect for the Project, and Furlow Associates, Inc. ("Furlow"), the mechanical and building management systems engineer for the Project. Nemours then filed an answer and counterclaim against Gilbane in each of the cases and claims pursuant to Rule 14 of the Federal Rules of Civil Procedure against Pierce and Dynalectric. Subsequently, Nemours twice amended these claims against Pierce and Dynalectric.

In April, 1984, both Pierce and Dynalectric answered Nemours' claims and asserted virtually identical counterclaims against Nemours. Nemours moved to dismiss on the basis that neither Pierce nor Dynalectric had stated claims upon which relief could be granted and that Dynalectric had not stated a claim properly within the subject matter jurisdiction of the Court. On October 31, 1984, following the briefing of these motions, both Pierce and Dynalectric amended their counterclaims against Nemours, and on November 7, 1984, the Court heard oral argument, at which time, Nemours represented that its motions to dismiss applied to both the original counterclaims as well as the amended counterclaims.[1] Thereafter, the two cases were consolidated with three other actions similarly arising out of disputes concerning the Project.

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1. On November 20, 1984, Nemours renewed its motions to dismiss, expressly indicating that the motions were to apply with respect to the amended counterclaims filed by Pierce and Dynalectric and that it would rely on the briefing previously submitted.

DISCUSSION

A. Dynalectric's Counterclaim Against Nemours—Subject Matter Jurisdiction

Nemours contends that Dynalectric's counterclaim is not properly within the subject matter jurisdiction of the Court since Nemours and Dynalectric are both citizens of Florida and no federal question is presented by the counterclaim.[2] In short, Nemours argues that in order for a plaintiff to assert a claim against a third-party defendant, there must be an independent jurisdictional basis for such a claim, notwithstanding that such a claim may be in the nature of a counterclaim asserted in response to a claim made by the third-party defendant against the original plaintiff. In support of its position, Nemours relies principally on *Owen Equipment & Erection Co. v. Kroger*, 437 U.S. 365, 98 S.Ct. 2396, 57 L.Ed.2d 274 (1978).

In response, Dynalectric contends that where a third-party defendant has asserted a claim against the original plaintiff pursuant to Fed.R.Civ.P. 14, and, as a result, the original plaintiff has asserted what is essentially a compulsory counterclaim against the third-party defendant, *Owen Equipment & Erection Co. v. Kroger*, does not require an independent basis for jurisdiction since such a claim is properly within the ancillary jurisdiction of the Court.

While both parties have vigorously contested this issue, the Third Circuit Court of Appeals has recently held that "if . . . a third-party defendant asserts claims under Rule 14(a) against [a] plaintiff, ancillary jurisdiction extends to support plaintiff's 'compulsory counterclaim' under Fed.R.Civ.P. 13(a)." *Finkle v. Gulf & Western Manufacturing Co.*, 744 F.2d

2. Dynalectric concedes that its counterclaim is not based on a federal question and that there is no diversity of citizenship between the two parties.

1015, 1018 (3d Cir.1984).[3] Since this decision is binding precedent, the controlling issue therefore is whether Dynalectric's claim against Nemours constitutes a "compulsory counterclaim".[4]

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3. *Finkle v. Gulf & Western Manufacturing Co.* involved a factual background remarkably similar to the case at bar. Plaintiff, as lessor, brought suit against, *inter alia*, Gulf & Western Manufacturing Company ("G & WM"), the lessee, to recover an amount allegedly owed for failure to renew the lease in a timely manner. Jurisdiction was based on diversity of citizenship. G & WM then impleaded Philmont Steel Products, Inc. ("Philmont"), the party to which G & WM had assigned its rights under the lease, on the basis of an alleged indemnification agreement. Philmont, in turn, filed a claim against the plaintiff to recover damages allegedly sustained by plaintiff's refusal to allow Philmont to renew the lease after the renewal deadline had passed. In response, plaintiff filed a counterclaim against Philmont for the sum owed for failure to timely renew the lease. However, as between plaintiff and Philmont, no diversity of citizenship existed.

The Third Circuit began its analysis of the jurisdictional issue presented by the case by noting that both G & WM's claims against Philmont and Philmont's claims against the plaintiff could be maintained absent an independent jurisdictional basis since they fell within the ancillary jurisdiction of the court. The court then extended the ambit of ancillary jurisdiction to cover plaintiff's claims against Philmont as well, commenting that "[s]uch claims are induced by the third-party's choice to assert its claims against plaintiff." 744 F.2d at 1018. Moreover, the court distinguished *Owen Equipment & Erection Co. v. Kroger, supra*, on the basis that *Owen* had simply prohibited the voluntary assertion by a plaintiff of an independent claim against a third-party defendant absent an independent jurisdictional basis. By contrast, the court found that the plaintiff in *Finkle*, as here, had chosen not to independently assert claims against the third-party defendant. Rather, it was only in response to the third-party defendant's assertion of claims against the plaintiff that the plaintiff had filed compulsory counterclaims.

4. As the Supreme Court noted in *Owen Equipment & Erection Co. v. Kroger, supra*, a determination as to whether a nonfederal claim between parties of the same state is properly within the scope of the subject matter jurisdiction of the federal courts involves a two-step analysis. First, the nonfederal claim must fall within the ambit of the federal judicial power created and limited by Article III of the Constitution.

> Pendent jurisdiction, in the sense of judicial *power*, exists whenever there is a claim 'arising under [the] Constitution, the Laws of

Rule 13(a) of the Federal Rules of Civil Procedure governs the assertion of compulsory counterclaims as follows:

> A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it *arises out of the transaction or occurrence* that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction. . . .

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the United States, and Treaties made, or which shall be made, under their Authority . . ." U.S. Const., Art. III, § 2, and the relationship between that claim and the state claim permits the conclusion that the entire action before the court comprises but one constitutional "case". . . . The state and federal claims must derive from a common nucleus of operative fact. But if, considered without regard to their federal or state character, a plaintiff's claims are such that he would ordinarily be expected to try them all in one judicial proceeding, then, assuming substantiality of the federal issues, there is *power* in federal courts to hear the whole.

437 U.S. at 371, 98 S.Ct. at 2401 (quoting *United Mine Workers v. Gibbs*, 383 U.S. 715, 725, 86 S.Ct. 1130, 1138, 16 L.Ed.2d 218 (1966) (emphasis in original)). While *United Mine Workers v. Gibbs* involved pendent jurisdiction and *Owen Equipment & Erection Co. v. Kroger* involved ancillary jurisdiction, the Court pointed out that it was unnecessary to decide whether there were any "principled" differences between ancillary and pendent jurisdiction. 437 U.S. at 370, n. 8, 98 S.Ct. at 2400, n. 8, since the cases involved two species of the same generic problem. *Id.* at 370, 98 S.Ct. at 2400.

Second, assuming that the Constitution confers the power on the federal courts to hear the nonfederal claims, such claims must be within the courts' jurisdiction as limited by Congress. *Id.* at 372-73, 98 S.Ct. at 2401–2. That is, even though nonfederal and federal claims may derive from "a common nucleus of operative fact", Congress may have precluded the federal courts from entertaining the nonfederal claims.

With this in mind, *Finkle v. Gulf & Western Manufacturing Co.*, *supra*, can be seen as an implicit determination by the Third Circuit that when a claim by a plaintiff against a third-party defendant is a "compulsory counterclaim" as that term is used in Fed.R.Civ.P. 13(a), such a claim and the "federal" claims contained in the case necessarily derive from a common nucleus of operative fact and the claim is within the ambit of the subject matter jurisdiction conferred upon the federal courts by Congress.

Fed.R.Civ.P. 13(a) (emphasis added).

Nemours does not contend that Dynalectric's counterclaim requires the presence of third parties over whom this Court cannot acquire jurisdiction. Hence, the key question is whether Dynalectric's counterclaim arises out of the same transaction or occurrence that formed the basis for Nemours' claims against Dynalectric.

In *Xerox Corp. v. SCM Corp.*, 576 F.2d 1057 (3d Cir.1978), the Third Circuit indicated that "the operative question in determining if a claim is a compulsory counterclaim is whether it bears a logical relationship to an opposing party's claim." *Id.* at 1059.

> [A] counterclaim is logically related to the opposing party's claim where separate trials on each of their respective claims would involve a substantial duplication of effort and time by the parties and the courts. Where multiple claims involve many of the same factual issues, or the same factual and legal issues, or where they are offshoots of the same basic controversy between the parties, fairness and considerations of convenience and of economy require that the counterclaimant be permitted to maintain his cause of action.

Id. (quoting *Great Lakes Rubber Corp. v. Herbert Cooper Co.*, 286 F.2d 631, 634 (3d Cir.1961)). *See also Paine, Webber, Jackson & Curtis, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 587 F.Supp. 1112, 1113-14 (D.Del.1984); *Wheaton Glass Co. v. Pharmex, Inc.*, 548 F.Supp. 1242, 1246 (D.N.J.1982); 3 J. Moore, *Moore's Federal Practice* ¶ 13.13 (2nd Ed. 1984).

A review of Nemours' claims against Dynalectric indicates that Dynalectric's counterclaim does in fact arise out of the same transaction or occurrence upon which Nemours'

claims are based. Both sets of claims relate to delays and disputes occurring during Phase 5B of the Project. More specifically, Nemours, as a third-party beneficiary of Dynalectric's subcontract with Gilbane, has charged Dynalectric with breaching its subcontractual obligations. Nemours has also demanded judgment against Dynalectric for damages allegedly resulting from Dynalectric's intentional and/or negligent failure to perform duties owed to Nemours in a timely and reasonably careful manner. Dynalectric, as will be discussed more fully hereinafter, has charged Nemours with failure to supply Dynalectric with accurate information, plans, and specifications upon which Dynalectric grounded its decision to enter into the subcontract with Gilbane, negligently and tortiously interfering with Dynalectric's contractual relationship with Gilbane, and retaining the benefit of Dynalectric's labor and materials without paying full compensation thereof.

Since Dynalectric's claims are clearly "compulsory counterclaims", I find that they properly fall within the ancillary jurisdiction of this Court. Therefore, Nemours' motion to dismiss Dynalectric's counterclaim for lack of subject matter jurisdiction must be denied.[5]

B. Pierce's and Dynalectric's Counterclaims Against Nemours—Substantive Challenges

As previously noted, the counterclaims filed by Pierce

5. I note in passing that the Third Circuit has recently established a three-tiered analysis to determine whether ancillary or pendent jurisdiction should be exercised in a particular case. *Abromovage v. United Mine Workers*, 726 F.2d 972, 989–991 (3d Cir.1984). First, there must be judicial power under the Constitution to entertain the nonfederal claims. Second, the exercise of ancillary or pendent jurisdiction must not violate federal policy decisions as generally embodied in the relevant federal rules and statutes. Finally, the exercise of jurisdiction over the ancillary or pendent claims must not offend prudential considerations of convenience, judicial economy, and fairness to the litigants. I find that my decision to invoke ancillary jurisdiction over Dynalectric's counterclaim against Nemours is consistent with this three-tiered analysis.

and Dynalectric against Nemours are virtually identical. Therefore, the following discussion is applicable to both counterclaims. In addition, the amendments which Pierce and Dynalectric made to their counterclaims following the completed briefing on Nemours' motions to dismiss have rendered some of Nemours' contentions moot. Indeed, at oral argument, Nemours withdrew its challenge to Count II of the amended counterclaims on the basis that the amended counterclaims concededly set forth a claim for fraudulent misrepresentation. Consequently, I need only focus on the assertions by Nemours which have not been cured by the amendments to the counterclaims.

The standard which governs motions to dismiss for failure to state a claim upon which relief can be granted is well known. As the Third Circuit Court of Appeals recently stated:

> The relevant legal precept is a familiar one; in deciding a Rule 12(b)(6) motion, factual allegations of the complaint are to be accepted as true and the complaint should be dismissed only if it appears to a certainty that no relief could be granted under any set of facts which could be proved. Reasonable factual inferences will be drawn to aid the pleader.

D.P. Enterprises, Inc. v. Bucks County Community College, 725 F.2d 943, 944 (3d Cir.1984).

Count I of the amended counterclaims of Pierce and Dynalectric advances a claim based on negligent misrepresentation. Pierce and Dynalectric allege that Nemours carelessly and negligently furnished them with both incomplete, inaccurate, and insufficient plans and specifications relating to the Project and incorrect information concerning the completion date of the prior phase (Phase 5EXT) of construction work on the Project. Pierce and Dynalectric further claim that they submitted their subcontract bids to Gilbane on the basis

of these false representations, and as a result, suffered increased costs and expenses in attempting to perform as required under the subcontracts with Gilbane. In short, Pierce and Dynalectric assert that the cost of and time required for the performance of their work under the subcontracts with Gilbane were substantially increased beyond what they had anticipated in preparing and submitting their subcontract bids since those bids were based on false information negligently supplied by Nemours.

As the primary basis for its challenge to Count I of the counterclaims, Nemours contends that Delaware law[6] does not recognize a cause of action for negligent misrepresentation.[7] At a minimum, Nemours argues, a misrepresentation must be made recklessly in order to be actionable. Mere negligence in propounding a misrepresentation is insufficient.

In response, neither Pierce nor Dynalectric have offered any Delaware cases which expressly recognize a cause of action for negligent misrepresentation. Rather, they argue that even if such a cause of action is without precedent in Delaware, this Court should hear their claims since their interests are entitled to legal protection.

Section 552 of the Restatement (Second) of Torts sets forth the contours of the cause of action for negligent misrepresentation, as follows:

> Information Negligently Supplied for the Guidance of Others
>
> (1) One who, in the course of his business, profes-

6. All the parties agree that Delaware law is controlling with respect to the substantive aspects of the counterclaims.

7. Nemours also contends that Count I must be dismissed since Pierce and Dynalectric have failed to allege that they were ignorant of the falsity of this information. This contention is without merit. The amended counterclaims clearly allege that Pierce and Dynalectric were unaware that the representations upon which they were relying were false.

sion or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

Restatement (Second) of Torts § 552 (1977).

While research has not disclosed any cases in which the Delaware courts have expressly embraced Section 552 of the Restatement (Second) of Torts as a correct statement of Delaware law,[8] I am convinced that the Delaware Supreme Court,

8. In *Employers Liability Assurance Corp. v. Madric*, 4 Storey 146, 54 Del. 146, 174 A.2d 809 (Del.Super.Ct.1961), *rev'd*, 4 Storey 593, 54 Del. 593, 183 A.2d 182 (Del.1962), the court ruled that where an insurance agent had negligently provided the insured with incorrect information concerning the scope of his automobile insurance coverage, the insurer was estopped by its agent's misrepresentations from using a restrictive clause in the policy as a means to avoid coverage. The court rejected the insurer's contention that carelessly providing misinformation was not actionable, 174

if confronted with this issue, would so hold. Moreover, I find that Count I of the counterclaims of Pierce and Dynalectric allege facts which, if proven, would satisfy the elements of the cause of action for negligent misrepresentation as described by this section of the Restatement (Second) of Torts. First, it is at least inferrable from the counterclaims that Nemours had a "pecuniary interest" in the transactions between Gilbane and Dynalectric and Pierce.[9] Second, Pierce and Dynalectric specifically allege that Nemours knew or should have known that they would rely on the inaccurate plans, specifications, and information concerning the completion of the preceding phase of the construction work provided to them by Nemours in preparing and submitting their subcontract bids to Gilbane. Third, Pierce and Dynalectric allege that Nemours did not exercise reasonable care in providing them with the inaccurate plans, specifications, and other information. Fourth, Pierce and Dynalectric sufficiently allege that they were part of the limited group of entities for whose benefit and

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A.2d at 813–14, relying in part on Restatement of Torts § 552, which parallels section 552 of the Restatement (Second) of Torts. However, the court used this part of its decision simply as a predicate for finding an estoppel against the insurer. On appeal, the Delaware Supreme Court reversed on grounds that the evidence failed to establish that the insurer's agent had misled the insured regarding the scope of his coverage so as to constitute an estoppel without addressing the lower court's discussion regarding § 552 of the Restatement of Torts.

More recently, in *Insurance Company of North America v. Waterhouse*, 424 A.2d 675 (Del.Super.Ct.1980), the court dismissed a fourth party complaint by an insurance company against an independent insurance agency alleging, *inter alia*, that the insurance agency had negligently disseminated information to the insured which injured the insurance company. The court found that section 552 of the Restatement (Second) of Torts was inapplicable since the complainant insurance company was not within the limited group of persons for whose benefit and guidance the insurance agency had supplied the information. *Id.* at 677–78.

9. The comments following section 552 indicate that a "defendant's pecuniary interest in supplying the information will normally lie in a consideration paid to him for it or paid in a transaction in the course of and as a part of which it is supplied. *It may, however, be of a more indirect character.*" Restatement (Second) of Torts § 552, comment d (1977).

guidance Nemours supplied the false information. Finally, Pierce and Dynalectric sufficiently allege that they suffered losses because of their reliance on this false information in performing the transactions that Nemours intended to influence through the dissemination of such information. Consequently, I must deny Nemours' motion to dismiss with respect to Count I of the counterclaims.[10]

Count III of the counterclaims of Pierce and Dynalectric sets forth claims against Nemours based on negligence. Spe-

10. Delaware law has long recognized a distinction between actions at common law for fraud or deceit and actions in equity for relief from fraud. With respect to the former, a necessary element of a common law fraud claim is a showing that the defendant made a false representation with the knowledge or belief that the representation was false, or at least with reckless indifference to the truth of the representation. *Stephenson v. Capano Development, Inc.*, 462 A.2d 1069, 1074 (Del.1983); *Nye Odorless Incinerator Corp. v. Felton*, 35 Del. 236, 162 A. 504, 510–11 (Del.Super.Ct.1931). By contrast, in an action at equity for relief from fraud, there is no requirement that the defendant have known or believed his or her statement to be false or to have made the statement in reckless disregard of the truth. Rather, equity provides a remedy for negligent and/or innocent misrepresentations.–*Stephenson v. Capano Development, Inc., supra*, 462 A.2d at 1074; *Eastern States Petroleum Co. v. Universal Oil Products Co.*, 24 Del.Ch. 11, 3 A.2d 768, 775 (1939). Judge Taylor summarized the law in this area as follows:

> Although intent to defraud or deceive is an essential element to relief at law, it is not essential to equitable relief if a false statement has been made.... In equity, misrepresentation may be founded merely upon a false statement even though its falseness is not known to the maker of the statement.... Misrepresentation does not require legal fraud.... In equity, it has been held that a person may be chargeable if he makes an untrue statement of fact and has no knowledge that the statement is true, even though he believed it to be true... or if one has a duty of knowing the truth and makes an untrue statement... or if the untrue statement results from one's own forgetfulness.

In re Brandywine Volkswagen, Ltd., 306 A.2d 24, 28 (Del.Super.Ct.), *aff'd*, 312 A.2d 632 (Del.1973). Therefore, to the extent that Count I of the counterclaims of Pierce and Dynalectric demands equitable relief, it likewise states a claim upon which relief can be granted in accordance with long established principles of Delaware law.

cifically, Pierce and Dynalectric allege that Nemours obstructed and interfered with their efforts to perform their work under the subcontracts with Gilbane in an orderly, efficient, and timely manner by negligently failing to process change estimates and proposals and change order amendments in a timely and proper manner, negligently failing to provide Pierce and Dynalectric with work schedules reflecting actual conditions existing at the Project, and negligently failing to provide Pierce and Dynalectric with updated and revised contract design drawings for the Project.

Nemours challenges Count III on the basis that Pierce and Dynalectric have failed to allege or demonstrate the existence of any legal duty owed them by Nemours. This is without merit since Count III of the amended counterclaims contains clear allegations that Nemours owed Pierce and Dynalectric a duty to exercise reasonable care in (1) processing change estimates and proposals and change order amendments, (2) providing reasonable and accurate schedules, and (3) providing updated and revised contract design drawings. Further, Count III of the counterclaims expressly alleges that Nemours owed Pierce and Dynalectric a duty not to hinder, delay, or interfere with their performance of their subcontractual obligations.

In addition, Nemours asserts that as a matter of law, neither Pierce nor Dynalectric can prove that Nemours owed them any duty of care since at most the acts and omissions set forth in Count III are breaches of duties owed by Nemours to Gilbane under the prime contract, or by Gilbane to Pierce and Dynalectric under the subcontracts. As support for this proposition, Nemours relies on *Harbor Mechanical Inc. v. Arizona Electric Power Cooperative, Inc.*, 496 F.Supp. 681 (D.Ariz.1980) (Arizona law). There, the court granted summary judgment against contractors who had brought claims against the engineering firm retained by the owner of a construction project alleging, *inter alia*, that the engineering firm had negligently drafted plans and specifications for the proj-

ect and had negligently supervised construction of the project. The court found that the contractors were neither parties to the contract between the engineering firm and the owner nor third-party beneficiaries of that contract. The court then indicated that for a negligence claim to be actionable, there must be the breach of some duty owed by the defendant to the plaintiff. While the court did not foreclose the possibility that the parties to a construction project could create the duties allegedly owed by the engineering firm to the contractors through contract, the court found that the contract between the engineering firm and the owner specifically provided that the engineer's obligations extended only to the owner thereby preventing the court from imposing any duties or obligations on the engineer with respect to the contractors.

The continuing validity of this decision is in serious doubt in light of the *en banc* decision by the Arizona Supreme Court in *Donnelly Construction Co. v. Oberg/Hunt/Gilleland*, 139 Ariz. 484, 677 P.2d 1292 (1984), holding that a contractor could maintain an action against an architectural firm absent privity of contract for negligently providing incorrect design plans and specifications. The court found that the defendant architectural firm was under a duty to use ordinary skill and care in providing plans and specifications which were sufficient and adequate and that this duty extended to both those with whom the firm was in privity and those with whom it was not. Since it was foreseeable that the plaintiff contractor would incur increased costs if the plans and specifications were in error, the court ruled that the contractor had stated a cause of action in negligence.

Similarly, in *Berkle & Company Contractors, Inc. v. Providence Hosp.*, 454 So.2d 496 (Ala.1984), the court, *inter alia*, reversed a decision granting summary judgment in favor of the defendant hospital where a subcontractor had brought claims against the hospital and its architect for negligently directing the subcontractor's activities with respect to the construction of an addition to the hospital. The court rejected

the hospital's argument that the subcontractor could not enforce the hospital's duties absent privity or third-party beneficiary status, stating:

> [The hospital] misconstrues the basis of duties in negligence actions. A plaintiff may argue that another party owes a duty under a contract upon which the plaintiff reasonably relied. . . . Alternatively, a plaintiff may argue that another party has duties independent of any contract because that party has acted affirmatively. . . . [The hospital] can be held liable for negligence injuring third parties, whether or not [the hospital] has a similar duty under contract to some others. The existence of a collateral contract does not negate the obligation imposed in tort to act reasonably.

454 So.2d at 502 (citations omitted).

Although the Delaware case law on this issue is somewhat meager, I am convinced that the Delaware Supreme Court would adopt the position embraced in *Donnelly Construction Co. v. Oberg/Hunt/Gilleland*, *supra*, and *Berkel & Company Contractors, Inc. v. Providence Hosp.*, *supra*, that in a construction dispute, privity of contract or third-party beneficiary status is not a prerequisite in all cases for bringing an action sounding in negligence.

In *Crowell Corp. v. Topkis Construction Co.*, 280 A.2d 730 (Del.Super.Ct.1971), the Delaware Superior Court held that an owner of a building could not bring a negligence action for faulty workmanship against a subcontractor which had assisted in the construction of the building where no "dramatic accident or collapse" had taken place and no person had "suffered physical injury" due to the subcontractor's alleged negligence absent privity of contract. *Id.* at 731-32. The court recognized that the privity requirement had been abandoned in cases involving accidents and/or physical injuries, but

refused to extend such a rule to cover situations involving only pecuniary loss relying principally on *Trans World Airlines v. Curtiss-Wright Corp.* 1 Misc.2d 477, 148 N.Y.S.2d 284 (1955), *aff'd*, 2 A.D.2d 666, 153 N.Y.S.2d 546 (1956), a case involving negligently manufactured airplane engines. While the court conceded that "[f]rom a social viewpoint there is much to be said in favor of the approach taken by [the owner]", *id.* at 731, it found that if the ultimate user of a manufactured item were allowed to sue the manufacturer in negligence "merely because an article with latent defects turned out to be bad when used in 'regular service' without any accident occurring, there would be nothing left of the citadel of privity and not much scope for the law of warranty." *Id.* at 732.

In *Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver, Inc.*, 312 A.2d 322 (Del.Super.Ct.1973), the Delaware Superior Court again confronted the issue of whether an owner could sue a subcontractor for negligent workmanship absent privity of contract. The court indicated that "[w]hile, even under the facts of *Crowell*, there may be some reason to question preservation of the citadel of privity, this opinion does not question the recent authority of *Crowell* in deciding Cannon's motion for summary judgment." *Id.* at 329. Rather, the court expanded *Crowell's* requirement that there be "an accident" in order to avoid the requirement of privity of contract to apply to a situation in which a subcontractor had negligently applied a polyester resin coating to the inside of chemical process tanks which began to deteriorate less than a year later.

> This is a case of physical injury to property and not mere economic loss. It can be reasonably argued that there has been an accident in the basic sense that there was in fact immediate physical injury to the storage tanks not caused by normal wear and tear.

Id. On appeal, the Delaware Supreme Court affirmed the lower court's decision denying summary judgment in favor of

the subcontractor on grounds that the owner was a third-party beneficiary of the subcontract. However, the court did not address the *Crowell* issue.[11] *Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver, Inc.*, 336 A.2d 211 (Del. 1975).

Shortly thereafter, however, in *Seiler v. Levitz Furniture Co.*, 367 A.2d 999 (Del. 1976), the Delaware Supreme Court upheld the right of a tenant of a shopping center to sue, *inter alia*, the architect of the shopping center for design defects resulting in flood damage to the tenant's store and the contents thereof. The court set forth alternative grounds for its holding as follows:

> Seiler [the architect] argues . . . that he was not in privity with Levitz. . . . *[A]s to privity, the case against Seiler was tried on a negligence basis* (not on a contract theory) *and, to the extent he relies on the absence of privity in product liability cases, the argument is without merit* in light of our recent decision in *Martin v. Ryder Truck Rental, Inc.*, Del.Supr., 353 A.2d 581 (1976). . . . In any event, Seiler is accountable to Levitz under third-party beneficiary principles. *Oliver B. Cannon & Son, Inc. v. Dorr-Oliver, Inc.* Del.Supr. 336 A.2d 211, 215 (1975). . . .
>
> For these reasons, we conclude that neither the absence of privity nor the other contentions made by Seiler on this issue are meritorious, and we affirm the Trial Court's conclusion that Levitz has a cause of action against Seiler.[12]

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11. In a footnote, the Supreme Court simply noted that "[o]n remand the parties are free to argue a tortious basis for damages in any way that is not inconsistent with this opinion." *Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver, Inc.*, 336 A.2d 211, 216 n. 6 (Del.1975).

12. In *Martin v. Ryder Truck Rental, Inc.*, 353 A.2d 581 (Del.1976), the Delaware Supreme Court held for the first time that under common law principles, a party could be held strictly liable for injuries caused by its defective product absent privity of contract. More specifically, the court ruled that where a bystander had been injured in an accident allegedly resulting from failure of the braking system of a truck rented from the defendant, the defendant could be held liable without proof of negligence and absent privity of contract.

Id. at 1006-1007 (emphasis added).

Since *Martin v. Ryder Truck Rental, Inc.*, 353 A.2d 581 (Del. 1976), clearly indicated that Delaware had abandoned common law privity requirements in the area of products liability cases, I am convinced that the Delaware Supreme Court in *Seiler*, by relying on *Martin*, was likewise indicating an intent to abandon privity as a prerequisite to bringing suit on a negligence theory to recover financial losses suffered in the construction context. Indeed, this was precisely the result in *Seiler*. Consequently, I am not prepared to rule at this time that, as a matter of law, Nemours owed no duty of care to Pierce and Dynalectric concerning the alleged actions and/or omissions by Nemours simply because Nemours does not stand in privity of contract with either Pierce or Dynalectric. Rather, a decision as to whether Nemours owed a duty of care to Pierce and Dynalectric must await the development of a factual record. Therefore, I must deny Nemours' motion to dismiss with respect to Count III of the amended counterclaims.[13]

Count IV of the counterclaims advances a claim based on the theory of tortious interference with contractual relations. Pierce and Dynalectric allege, *inter alia*, that Nemours intentionally failed to timely and properly process change estimates and proposals and change order amendments, to approve realistic and reasonable work schedules, and to provide updated and revised contract design drawings thereby preventing Pierce and Dynalectric from performing their obligations under the subcontracts with Gilbane and inducing Gilbane to

---

13. The concerns identified by the court in *Crowell Corp. v. Topkis Construction Co., supra*, as to allowing recovery for pecuniary losses suffered from "defects" in mass produced items are apparently viewed by the Delaware Supreme Court as inapplicable in the context of a typical construction project. Owners, architects, engineers, contractors, subcontractors, and suppliers all rely on each other to varying degrees to ultimately achieve a completed structure. This interdependence differentiates the calculus of foreseeable harm in this context from other contexts such as the manufacturing of mass produced items.

materially breach these subcontracts. Moreover, Pierce and Dynalectric allege that by filing actions against Gilbane, Pierce, and Dynalectric in the Florida state courts in February, 1983, Nemours induced Gilbane to repudiate and anticipatorially breach its subcontracts with Pierce and Dynalectric.

The parties agree that *DeBonaventura v. Nationwide Mutual Insurance Co.*, 419 A.2d 942 (Del.Ch.1980), *aff'd*, 428 A.2d 1151 (Del.1981), correctly sets forth the elements of a cause of action for tortious interference with contractual relations. As Chancellor Marvel stated:

> [I]nterference with an existing contract requires (a) an intent to induce a breach (b) of an existing contract, (c) proximate causation, and (d) damages. . . .

419 A.2d at 947. I find that Count IV of the amended counterclaims of Pierce and Dynalectric sufficiently alleges each of these elements.

Nemours argues that dismissal of Count IV is required because Pierce and Dynalectric have not alleged that Nemours induced Gilbane to breach its subcontract with Peirce and Dynalectric and have not alleged that the tortious interference was the result of intentional as opposed to negligent conduct. This position is untenable. While Count IV of the amended counterclaims embraces all the prior allegations including the allegations of negligent conduct, it specifically contains allegations that Nemours, *inter alia*, *intentionally* refused to process change order amendments in a timely manner, to provide updated design drawings, and to approve reasonable work schedules thereby inducing Gilbane to materially breach its subcontracts with Pierce and Dynalectric. Hence, Count IV clearly alleges that the claimed tortious interference with contractual relations was caused by intentional rather than negligent conduct. Moreover, I find that it

can be fairly inferred from the allegations of such intentional conduct that Nemours intended to induce a breach of the subcontracts between Gilbane and Pierce and Dynalectric. In addition, Count IV alleges that Nemours knowingly induced Gilbane to repudiate these subcontracts by initiating litigation against Gilbane, Pierce, and Dynalectric in Florida. This likewise clearly supports an inference that Nemours intended to induce a breach of the subcontracts. Therefore, I must deny Nemours' motion to dismiss with respect to Count IV of the amended counterclaims.[14]

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14. Nemours advances the additional argument that even if Nemours did interfere in some way with Pierce's and Dynalectric's subcontractual relations with Gilbane, such interference was not "improper", since it was simply exercising rights available to it as owner of the Project and/or pursuant to the various contracts. Hence, Pierce and Dynalectric have failed to state actionable claims for tortious interference with contractual relations. I do not agree.

As the Fifth Circuit per Judge Wisdom stated in *Thompson v. Allstate Insurance Co.*, 476 F.2d 746 (5th Cir.1973), a case involving a claim for tortious interference with business relations, "[j]ustification for interference in another's business is an affirmative defense and is no part of the plaintiff's case. It 'is enough to allege and prove the conduct and effect, leaving the defendant to justify if he can'". *Id.* at 748 (quoting *American Well Works Co. v. Layne & Bowler Co.*, 241 U.S. 257, 259, 36 S.Ct. 585, 586, 60 L.Ed. 987 (1916) (Holmes, J.)). Under this standard, the court refused to dismiss plaintiff's complaint for failure to state a claim.

Similarly, in *Leeward Petroleum, Ltd. v. Mene Grande Oil Co.*, 415 F.Supp. 158 (D.Del.1976), Judge Wright rejected a motion to dismiss directed at claims, *inter alia*, alleging tortious interference with contractual relations where the defendant asserted that its acts were privileged and therefore could not constitute tortious interference. The court commented as follows:

> This Court cannot now accede as a matter of law that such a privilege, if it exists, applies here. . . . [B]efore the court could rule on such a question, it would require a factual showing on the background of the transaction, and the respective interests of all the parties. *Such a factual showing must await summary judgment or trial.*

Id. at 164 (emphasis added).

Nemours' argument that it was somehow justified in allegedly interfering with the subcontractual relations between Gilbane, Pierce, and Dynalectric necessarily depends on facts not in the record before me on these motions to dismiss and, as such, cannot be decided at this time. Moreover, whether

Count V of the amended counterclaims of Pierce and Dynalectric sets forth a claim against Nemours to recover the value of uncompensated work performed by Pierce and Dynalectric on the basis of the doctrine of quantum meruit. Pierce and Dynalectric reaver the prior allegations of the amended counterclaims and assert that Nemours' alleged actions so substantially interfered with Pierce's and Dynalectric's subcontractual duties that Pierce and Dynalectric are entitled to treat their subcontracts with Gilbane as repudiated or "cardinally" breached. Pierce and Dynalectric then claim that since Nemours has received and retained the benefits of the materials and labor provided by Pierce and Dynalectric under their subcontracts for which Pierce and Dynalectric have not been fully compensated, Nemours has been unjustly enriched and should be required to pay Pierce and Dynalectric for the benefits thus conferred.

Nemours contends that Count V of the counterclaims fails to state a claim upon which relief can be granted because there is no right to bring an action based on quasi-contract principles where an express contract governs. More specifically, Nemours argues that the fact that Pierce and Dynalectric and Gilbane expressly contracted for the provision of materials and services which Pierce and Dynalectric now claim unjustly enriched Nemours bars any recovery against Nemours on a quantum meruit theory since Pierce and Dynalectric are limited to seeking relief from Gilbane pursuant to their subcontracts.

I am convinced that the law of Delaware precludes granting relief under Count V given the facts which have been alleged.[15] Stripped to its bare essentials, Count V alleges that

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or not Nemours' conduct was justified is in the nature of a defense. It is sufficient at this stage of the proceedings that Pierce and Dynalectric have properly stated claims upon which relief can be granted. With respect to Count IV of the amended counterclaims, I have so found.

15. As with the negligence issue, the parties have provided little assistance with respect to this issue, citing absolutely no Delaware state court decisions.

Pierce and Dynalectric have conferred upon Nemours a benefit for which they have not been fully compensated and that it would be inequitable to allow Nemours to retain this benefit without compensating Pierce and Dynalectric. There are no allegations that Pierce and Dynalectric will not ultimately be compensated by Gilbane or that Nemours has failed to pay Gilbane for the services rendered by Pierce and Dynalectric under the subcontracts.

In *Cohen v. Delmar Drive-In Theatre, Inc.*, 45 Del. 427, 84 A.2d 597 (Del.Super.Ct.1951), the court held that "[a] materialman who, as subcontractor, furnishes materials upon the order and credit of a general contractor or another subcontractor, cannot recover in an action *in personam* against the owner upon the basis of implied contract arising from the receipt and acceptance of the benefit of the materials furnished." 84 A.2d at 598. The court indicated that there was no privity of contract between the plaintiff subcontractor and the defendant owner and found that a judgment in favor of the subcontractor was thereby precluded. *Id.*

Cohen v. Delmar Drive-In Theatre, Inc. seems to follow the general rule set forth in *Board of Public Education v. Aetna Casualty & Surety Co.*, 34 Del. 355, 152 A. 600 (Del.Super.Ct.1930). There, the court found that by the terms of a surety bond entered into between the defendant surety firm and the prime contractor, a supplier to a subcontractor properly stated a cause of action under the bond for payment for materials supplied to the subcontractor. However, of importance to the case at bar, the court also commented as follows:

> We take it to be the established law that where a person employs another to do work for him, he is not liable to an action for services performed in the work by a third person solely on behalf of such second person nor for materials furnished by such third person to such second person under a contract between them alone. There is no privity between the

> first party and third—the contract being solely between the sub-contractor and laborer or material man as the case may be.

152 A. at 603.

More recently, in *Chrysler Corp. v. Airtemp Corp.*, 426 A.2d 845 (Del.Super.Ct.1980), the court addressed whether a party to a contract could recover from a third-party beneficiary to that contract the value of services rendered. Specifically, Chrysler entered into a contract with Fedders Corporation whereby Fedders agreed to purchase most of the assets of Chrysler's Airtemp Division. To effectuate this transfer, Fedders created Airtemps (the defendant), a wholly owned subsidiary to which the assets in question were transferred. Fedders also agreed to pay Chrysler for providing certain services to Airtemps for a period following the transfer. After allegedly not receiving payment for these services, Chrysler sued Airtemps on, *inter alia*, a quantum meruit theory. The court ruled that Airtemps, the third-party beneficiary of the contract between Chrysler and Fedders, could not be held liable "on the theory of quantum meruit or implied contract, at least in the absence of inability to recover under the underlying contract." *Id.* at 854.[16]

In the case at bar, Pierce and Dynalectric seek a judgment in their favor against Nemours, the third-party beneficiary of their subcontracts with Gilbane. While Pierce and Dynalectric allege that they have not been fully compensated for their services and materials, and that Nemours has retained the benefits thereof, there is no allegation that they will be unable to recover full compensation for these services and

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16. The court likewise rejected Chrysler's argument that it was entitled to recovery from Airtemps on the basis of restitution, finding that the benefits retained by Airtemps did not constitute unjust enrichment, since, as the third party beneficiary to the contract, Airtemps was entitled to receive such services. *Id.* at 854–55.

materials from Gilbane. Moreover, Count V of the amended counterclaims is devoid of any factual allegations from which one could conclude that Nemours has been *unjustly* enriched. Therefore, Nemours' motion to dismiss with respect to Count V of the amended counterclaims will be granted.

CONCLUSION

For the foregoing reasons, I conclude that this Court has subject matter jurisdiction over Dynalectric's amended counterclaim against Nemours, that Nemours' motions to dismiss Count V of the amended counterclaims of Pierce and Dynalectric should be granted and that its motions to dismiss Counts I through IV of these counterclaims should be denied.

District Court Oral Opinion and Order of August 18, 1986

IN THE UNITED STATES DISTRICT COURT
IN AND FOR THE DISTRICT OF DELAWARE

THE NEMOURS FOUNDATION, GILBANE BUILDING COMPANY, and AETNA CASUALTY & SURETY COMPANY,
Plaintiffs,

v.

PIERCE ASSOCIATES and FEDERAL INSURANCE COMPANY,
Defendants.

(Civil Action No. 83-58-JJF)

Wilmington, Delaware
August 18, 1986

Before: HONORABLE JOSEPH J. FARNAN, JR., U.S.D.C.J., and a jury

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[The following occurred in the absence of the jury:]

THE COURT: I will give the Court's decision with regard to the directed verdict motion of Pierce.

In determining whether to grant Pierce's motion for a directed verdict against Gilbane and Nemours, this Court must determine whether sufficient evidence has been produced which when exposed to the strongest light against the party to whom the motion is made and after giving them the advantage of every fair and reasonable inference, a reasonable jury could find for the non-moving party without engaging in speculation or conjecture. Sufficient evidence in Federal Courts constitutes evidence beyond a mere scintilla.

With regard to Pierce's motion for directed verdict against Nemours—which is the one I will take up first—on Count 1, breach of contract, Nemours asserts an action for breach of contract against Pierce. Pierce moved for directed verdict on this count on the basis that no contractual relationship exists between Pierce and Nemours.

I find that based on a reading of the contracts and of Judge Latchum's March 15, 1984 omnibus order, and the applicable Delaware law, that Nemours is a third-party beneficiary of Pierce's subcontract with Gilbane and therefore can maintain an action for breach of contract against Pierce.

On Count 2, negligence, Nemours asserts an action for negligence against Pierce. Pierce moves for directed verdict on Count 2 on the basis that Nemours must establish duties that exist at law outside the contract and that the only duties evidenced by Nemours were duties Pierce had to Gilbane pursuant to the subcontract.

I find, after reviewing Judge Latchum's and Judge Stapleton's Opinions and orders and the applicable Delaware law that there is support for Nemours' right to maintain an action against Pierce for breach of Pierce's implied duty to perform its contract obligations in a careful, reasonable and workmanlike manner.

Breach of this implied duty states an action in negligence. Therefore Pierce's motion for a directed verdict on Count 2 is denied.

However, as Judge Latchum pointed out and held in his omnibus order, Nemours must elect between a breach of contract theory and a negligence theory. This election must be made by Nemours before the case is submitted to the jury.

On Count 3, malicious breach of contract, Nemours asserts an action for malicious breach of contract and for

attorneys' fees and costs. Pierce moves for directed verdict on Count 3 on the basis that Nemours has not presented sufficient evidence to support its claim for punitive damages.

In determining the standard for conduct which supports an award of punitive damages, based on malicious breach of contract, I rely upon the applicable Delaware case law. Delaware law recognizes an exception to the general rule that punitive damages will not be awarded in a breach of contract case. However, where the breaching conduct is similar in nature to conduct warranting punitive damages in a tort case, punitive damages may be warranted in a breach of contract case.

The standard established in Delaware for conduct warranting punitive damages in an insurance contract case is that the defendant must have acted maliciously and without probable cause for the purpose of injuring its insured by depriving him of the benefits of the policy—and there is a citation to the Cannon case, 484 Fed.Supp. 1373, at 1387, a District of Delaware case.

Drawing on this standard for insurance contracts which I have cited, I find that in order to warrant punitive damages in construction contract cases, the breaching party must have acted maliciously, without regard to the contract language and its objectives, thus rendering the contract of the parties meaningless in the conduct of the business.

I find that the record indicates that Nemours presented sufficient evidence that Pierce acted in this manner, specifically Pierce requested Nemours to modify the contract specifications to permit use of Victaulic couplings on piping systems. Nemours granted this request only for pipes 2½ inches and larger. However, Pierce installed it on so much 2-inch pipe that the cost of delay involved in remedying the Victaulic couplings and welding joints was so high that

Nemours agreed to let the work stand. However, Pierce was to give Nemours a credit, but never did.

Another example of Pierce's disregard for contract specifications was its use of shrink bands instead of welded joints on dry vac system. Nemours, due to Pierce's delay in building the dry vac system, agreed that Pierce could use shrink bands on pipe up to three inches. Pierce installed it on four-inch pipe. After being advised in writing to remove the improper shrink bands and weld those joints, Pierce proceeded to install the shrink bands on pipe up to eight inches, resulting in more than 350 to 400 improper joints.

Pierce initially offered Nemours a $14,000 credit, after Nemours' computation of time and material showed Pierce saved $200,000, and therefore rejected Pierce's credit. Pierce demanded extra moneys for the shrink bands.

The record contains other examples, and, as I have previously cited, these are only examples of evidence in the record, not my conclusions, of Pierce's unilateral decision not to follow the contract language and specifications.

Based on this record, therefore, Nemours has presented sufficient evidence of malicious breach of contract for this Court to allow this count to go to the jury, and therefore Pierce's motion for directed verdict is denied.

On attorneys' fees and costs, Pierce claims statutory contractual authority is necessary for an award of punitive damages, which includes attorneys' fees. Nemours asserts that Delaware and Federal law permits such punitive damages, when the jury finds that the non-prevailing party acted in bad faith, vexatiously, wantonly or oppressively prior to or during the litigation.

I find that if the jury finds that Pierce maliciously

breached its contract, then Nemours will have an action for punitive damages, which includes attorneys' fees and costs.

On Count 4, Nemours had sought to recover for injuries suffered as a result of Pierce's fraudulent misrepresentations. Pierce moved for a directed verdict on Count 4 on the basis that Nemours has not prevented sufficient evidence to support all the elements of fraud required by Delaware law.

With regard to this—and to state it simply—Pierce's motion for directed verdict on Count 4 is granted. By presenting evidence that Pierce misrepresented its manpower, the per cent of the contract completed, its expenditures requested on payment requisitions and invoices, and its status as the party financing the job by expending more money than Nemours was paying it each month, Nemours has presented sufficient evidence for a jury to reasonably find that Nemours has fully proven fraudulent misrepresentation.

However, Nemours has not presented any evidence of justifiable reliance. If anything, Nemours presented evidence of its recognition of Pierce's misrepresentation through correspondence and testimony, and with this knowledge Nemours proceeded in its relationship with Pierce for reasons although understandable demonstrate that Nemours was not relying on Pierce's misrepresentations.

Therefore Nemours has demonstrated a lack of justifiable reliance and a possibly strategic decision to risk reliance in favor of an overall job progress.

Count 5, contribution, indemnification and liquidated damages. Nemours asserts that it has an action against Pierce for contribution as a joint tort feasor for the amounts paid by Nemours to the subcontractors in settlement of their claims, and, in the alternative, for indemnification for these sums based on Pierce's status as a sole tort feasor.

Nemours also asserts it is entitled to liquidated damages of $3,000 per day for each day of delay.

Pierce has requested a directed verdict on the contribution claim on the basis that a Nemours settlement with the subcontractors did not extinguish the subcontractors' rights to proceed against Pierce.

A directed verdict is sought on the indemnification claim as it pertains to delay damages incurred by the subcontractors with whom Nemours settled on the basis that Nemours cannot receive both actual damages and liquidated damages for the same economic loss.

My decision is, first with regard to contribution: Nemours' evidence that it was a joint tort feasor to the subcontractors with Pierce is certainly limited and possibly non-existent, and it would be incongruous for Nemours to admit to being a joint tort feasor, especially given its white knight characterization of its efforts at ameliorating the problems allegedly caused by Pierce and its claim for fraud and malicious breach of contract, or for the purpose of this motion I will assume that there is sufficient evidence in Nemours' case-in-chief to support a jury's finding that Nemours was a joint tort feasor with Pierce in causing injuries to the other subcontractors. Should the jury make this find of fact, Nemours would be entitled to contribution if it satisfied the Delaware joint tort feasors statute, Section 6302 of the Delaware Code Annotated, entitled, Right of Contribution. In that statute there are set forth the requirements for Nemours to receive contribution. Nemours has met the first two elements by, one, making a payment to the other subcontractors, which, No. 2, discharged its liability to them. However, Nemours' contribution claim failed because the settlement agreement did not extinguish the other subcontractors' rights to recover against Pierce, even though the other subcontractors are not now or have not previously sought relief against Pierce.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 88-3053, 88-3260, 88-3263

PIERCE ASSOCIATES, INC. and
FEDERAL INSURANCE CO.,
Appellants and Cross-Appellees

v.

THE NEMOURS FOUNDATION,
GILBANE BUILDING COMPANY, and
THE AETNA CASUALTY & SURETY COMPANY,
Appellees and Cross-Appellants

Appeal from the United States
District Court
for the District of Delaware
(D.C. Civil No. 83-58)
Present: SLOVITER and HUTCHINSON, *Circuit Judges*, and DEBEVOISE, *District Judge*[*]

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the District of Delaware and was argued by counsel October 17, 1988.

On consideration of the judgments of the said District Court entered December 28, 1987 and April 15, 1988, it is now here ordered and adjudged by this Court that the final judgment entered by the said District Court be modified as follows:

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[*]Honorable Dickinson R. Debevoise, United States District Judge for the District of New Jersey, sitting by designation.

Paragraph 1 which awards Nemours damages and interest against Pierce and Federal for Pierce's negligence and breach of contract will be reversed. Paragraph 2 which awards Nemours damages and interest against Pierce for indemnity payments will be reversed. Paragraphs 3 and 4 which award Nemours, respectively, punitive damages plus interest and attorney fees and consultants' costs plus interest will be reversed. Paragraph 5 which awards Gilbane damages and interest against Pierce and Federal for Pierce's breach of contract will be modified as follows: The amount of the recovery before interest will be $269,699.22. Post-judgment interest (including interest on pre-judgment interest) will be computed at the rate of 5.63%. On remand the said District Court will ascertain the proper date or dates from which pre-judgment interest shall be computed (at the rate of 13½%). Paragraph 6 of the final judgment will be modified to provide that each party shall bear its own costs.

All of the above in accordance with the opinion of this Court.

ATTEST:

_____

Clerk

December 29, 1988

SUR PETITION FOR REHEARING

PRESENT: GIBBONS, *Chief Judge*, SEITZ, HIGGINBOTHAM, SLOVITER, BECKER, MANSMANN, GREENBERG, HUTCHINSON, SCIRICA, COWEN, NYGAARD, *Circuit Judges*, and DEBEVOISE, *District Judge*[*]

The petition for rehearing filed by cross-appellants The Nemours Foundation and Gilbane Building Company in the above captioned matter having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

_____

Circuit Judge

DATED: February 3, 1989

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[*] Hon. Dickinson R. Debevoise of the United States District Court for the District of New Jersey sat by designation on the original panel.

Supreme Court, U.S.
FILED
JUN 2 1989
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-1790

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

THE NEMOURS FOUNDATION, GILBANE BUILDING COMPANY, AND THE AETNA CASUALTY & SURETY COMPANY,

Petitioners,

v.

PIERCE ASSOCIATES, INC. AND FEDERAL INSURANCE COMPANY,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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No. 88-1790

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

THE NEMOURS FOUNDATION, GILBANE BUILDING COMPANY, AND THE AETNA CASUALTY & SURETY COMPANY,

Petitioners,

v.

PIERCE ASSOCIATES, INC. AND FEDERAL INSURANCE COMPANY,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

This is a diversity case in which the Court of Appeals for the Third Circuit decided two issues of Delaware law in favor of Respondent Pierce Associates, Inc. and its surety, Federal Insurance Company,[1] and adversely to Petitioner The Nemours Foundation. The Court held that (1) Nemours was not an intended third party beneficiary of the subcontract between Petitioner Gilbane Building Company (Nemours' general contractor) and Pierce; and (2) Nemours could not maintain a cause of action in negligence against Pierce for the recovery of mere economic loss. These determinations were set forth in a cogent, well-reasoned opinion and constitute a correct application of Delaware law.

1. Pursuant to Supreme Court Rule 28.1, Respondents state that Federal Insurance Company is a wholly-owned subsidiary of the Chubb Corporation, whose stock is publicly traded. Pierce has no publicly traded parent, subsidiary or affiliate corporations.

This case does not involve any federal constitutional claim or any federal question, and the Court of Appeals' decision does not conflict with any decision by this Court or by a court of appeals from any other circuit. In sum, there exist no "special and important" reasons for granting a writ of certiorari in this case.

COUNTERSTATEMENT OF THE CASE

The construction project which is the subject of this litigation was plagued by serious delays and disputes over contract plans and specifications, design revisions, job progress schedules, progress payments, and change orders. (A7) In these disputes, general contractor Gilbane sided with its mechanical subcontractor Pierce and its numerous other subcontractors in asserting that responsibility for the delays and difficulties was attributable solely to Nemours (the project owner) and its architect and engineer. (A7-8).

On April 5, 1983, Gilbane filed a Complaint against Nemours and its architect and engineer seeking compensation for delay damages. On that same day, pursuant to its prior agreement with Gilbane, Pierce filed a breach of contract action against Gilbane (the only party with whom it was in privity) seeking compensation for delay damages and monies earned on the project but withheld by Nemours. These actions were consolidated with similar actions filed subsequently by other Gilbane subcontractors. Nemours counterclaimed against Gilbane, and also asserted claims directly against Pierce and the other subcontractors, alleging that it was a third-party beneficiary of Gilbane's subcontracts and was also entitled to recover in negligence for its economic loss.

During the first two years of the litigation, Gilbane continued to side with Pierce and the other subcontractors and against Nemours and its architect and engineer. Most importantly, Gilbane took positions on the third-party beneficiary and economic loss issues which are completely contrary to the positions it is now espousing in the Petition for Certiorari which it has filed jointly with Nemours and Aetna (Gilbane's surety) in this Court. Gilbane filed numerous

pleadings which unequivocally asserted that "Nemours is not a third-party beneficiary of the subcontract between Gilbane and Pierce".[2] Also, Gilbane filed a motion to dismiss Nemours' negligence counterclaim against it, arguing that under Delaware law "there exists no cause of action for mere economic loss arising out of tort or the alleged negligent breach of contract in the absence of property damage or personal injury". (Civil Action No. 83-195, Docket no. 89 at p. 4).[3]

In March, 1985, two months before the originally scheduled trial date and just before the scheduled depositions of Gilbane's key personnel, Nemours settled with Gilbane and they joined in asserting claims against Pierce. Gilbane received $4,025,000 from Nemours and its architect and engineer pursuant to this settlement, and subsequently paid out $3,669,000 of that sum to subcontractors other than Pierce to settle their delay claims. Gilbane retained $356,000 for itself. (A9) Significantly, the Nemours-Gilbane Settlement Agreement further provided that Gilbane would be entitled to share with Nemours on a 50-50 basis the first $8 million of any possible recovery against Pierce. (A9)[4] Subsequent to that settlement, the court realigned the parties to reflect Gilbane's sudden and drastic change in allegiance, designating Nemours and Gilbane as co-plaintiffs and Pierce and Federal as defendants. (A9) At trial, Gil-

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2. Civil Action No. 83-195, Docket nos. 33, 94, 166, and 259. Petitioner Aetna also filed pleadings asserting that Nemours was not a third-party beneficiary of the Gilbane-Pierce subcontract. Civil Action No. 83-195, Docket nos. 167 and 260.

3. During argument on this motion, Gilbane's counsel further contended that "in a wide spectrum of the law, from admiralty on the one hand all the way to products liability on the other, even the very liberal products liability area, if you have not alleged property damage or personal injury, you cannot sue in negligence for pure economic loss". (Civil Action No. 83-58, Docket no. 136 at p. 34).

4. In addition, Gilbane promised in the Settlement Agreement to cooperate with Nemours in its lawsuit against Pierce by forsaking any claim or defense based on Nemours' actions, to seek commitments from its other subcontractors to cooperate with Nemours in a similar fashion, and to refrain from settling with Pierce without Nemours' written consent. (A9)

bane's witnesses agreed with Nemours that Pierce was solely responsible for the delays and difficulties experienced on the project, notwithstanding Gilbane's long-maintained position prior to settlement that Nemours was responsible for those problems. The combined efforts of Nemours and Gilbane at trial resulted, not surprisingly, in a verdict in their favor and against Pierce.

On appeal, the Court of Appeals held, *inter alia*, that the jury verdict in favor of Nemours and against Pierce and Federal should be disallowed, because Nemours' third-party beneficiary and negligence claims were both deficient as a matter of Delaware law.[5] Nemours and Gilbane subsequently filed a Petition for Rehearing In Banc, but that Petition was denied. Not a single judge registered a dissent from the Court's denial of rehearing *in banc*.

Nemours' complaint that the Third Circuit's decision was unjust is fatuous. Nemours had an adequate remedy for recovery of its alleged damages, namely, pursuit of its claims against its general contractor, Gilbane. However, it made a tactical decision to settle those claims and collaborate with Gilbane, knowing that their combined efforts and resources would likely result in a substantial verdict against Pierce. Thus, Nemours voluntarily relinquished its sole legitimate means of securing redress for its alleged damages and, to the extent that it has not been made whole for those alleged damages, its injury was entirely self-inflicted.

REASONS FOR DENYING THE WRIT

A. THIS CASE ONLY INVOLVES ISSUES OF STATE LAW.

This diversity case only involves two issues of Delaware law, and the Third Circuit correctly followed the

5. The decision with respect to the negligence claim was unanimous; Judge Sloviter dissented from the Court's opinion only on the third-party beneficiary issue. Judge Sloviter stated that she nevertheless would have vacated the jury's verdict on account of the trial court's legally erroneous decision to preclude Pierce's President from testifying as an expert witness because of his pecuniary interest in the outcome. (A41-43) The majority had found this evidentiary ruling "troublesome" (A24), but did not decide that issue in light of its holding that Nemours' claims were legally deficient.

teaching of *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938), in applying Delaware law on those two issues. Thus, there are no "special and important reasons" for granting certiorari here. As this Court has repeatedly and consistently declared, "We have a settled and firm policy of deferring to regional courts of appeals in matters that involve the construction of state law". *Bowen v. Massachusetts*, U.S. , 108 S.Ct. 2722, 2739 (1988). *Accord Sheridan v. United States*, U.S. , 108 S.Ct. 2449, 2455 (1988); *Haring v. Prosise*, 462 U.S. 306, 314 n. 8 (1983) ("a challenge to state-law determinations by the court of appeals will rarely constitute an appropriate subject of this Court's review. See this Court's Rule 17."); *Butner v. United States*, 440 U.S. 48, 58 (1979); *Cort v. Ash*, 422 U.S. 66, 73 n. 6 (1975); *Pierson v. Ray*, 386 U.S. 547, 558 n. 12 (1967); *Commissioner v. Estate of Bosch*, 387 U.S. 456, 462 (1967); *Richards v. United States*, 369 U.S. 1, 16 n. 35 (1962); *The Tungus v. Skovgaard*, 358 U.S. 588, 596 (1959); *Allegheny County v. Mashuda Co.*, 360 U.S. 185, 191 (1959); *General Box Co. v. United States*, 351 U.S. 159, 165 (1956); *Ragan v. Merchants Transfer & Warehouse Co.*, 337 U.S. 530, 534 (1949).

As discussed more fully below, the Third Circuit's decision on the third-party beneficiary and economic loss issues represented a correct application of Delaware law. Thus, there is no reason to depart here from this Court's "settled and firm policy" of declining to review courts of appeals' determinations of state law. *Bowen v. Massachusetts, supra.*[6]

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6. As noted by Petitioners (Petition at 6 n.1), in a case filed by Nemours against a different subcontractor subsequent to the Third Circuit's denial of rehearing *in banc* in this case, the Delaware district court certified to Delaware's Supreme Court on May 2, 1989 the same two issues of state law previously decided against Nemours by the Third Circuit. *Nemours v. Manganaro Corp.*, C.A. 89-138. On May 31, 1989, the Third Circuit dismissed Manganaro's appeal from that decision as premature and also denied a Petition for Mandamus filed by Pierce in its capacity as *amicus curiae*. Nos. 89-3305, 3306. The Delaware Supreme Court has not yet decided whether to grant certification in the *Manganaro* case. In any event, the certification proceeding in that case in no way requires a deviation from this Court's "settled and firm policy" of refusing to grant certiorari in cases involving only issues of state law.

B. THE THIRD CIRCUIT'S DECISION DOES NOT CONFLICT WITH ANY DECISION BY THIS COURT OR BY A COURT OF APPEALS FROM ANY OTHER CIRCUIT.

Recognizing this Court's longstanding practice of refusing to grant certiorari in cases which only involve issues of state law, Petitioners attempt to camouflage their request for review of state law claims by arguing that this case presents the "ideal vehicle" for this Court to eliminate the "confusion" and "uncertainty" which they claim now prevail in the courts of appeals concerning the proper application of state law in diversity cases. They attribute this purported "confusion" and "uncertainty" in the courts of appeals to this Court's "lack of guidance" (Petition at 6-7), "mixed messages" (*Id.* at 14), "uneven direction" and "lack of direction" (*Id.* at 16, 17, 20 and 21), and "seemingly contradictory decisions" (*Id.* at 17) concerning the proper means of applying state law in a diversity case. However, Petitioners' claims of "confusion" and inter-circuit "conflict" are made up out of whole cloth.

Petitioners' repeated string-citations to a plethora of decisions by the courts of appeals cannot mask their failure to cite *any* decision by this Court or by a court of appeals from another circuit which conflicts with the Third Circuit's decision in this case. They have not cited *any* opinion by a member of this Court (either on behalf of the Court, in dissent or in concurrence) referring to the supposed "confusion" which Petitioners claim now reigns in the courts of appeals with respect to the determination of state law in diversity cases. Nor have they cited *any* decision by any court of appeals complaining of inadequate guidance from this Court concerning the proper means of applying state law.

In reality, the courts of appeals are *not* "hopelessly confused and inconsistent" (Petition at 14) in making their determinations of state law in diversity cases, as this Court has provided clear and consistent direction on how they should perform that task. Indeed, the long passage of time since this Court last deemed it necessary to address that

issue is testament to the fact that the courts of appeals have been determining state law in a manner consistent with one another and with the direction this Court provided in *Erie* and its progeny. There is simply no need at this time for this Court to re-visit the well-settled issue of how federal courts sitting in diversity should determine state law. Moreover, this case would hardly provide the "ideal vehicle" for such a review, as claimed by Petitioners (Petition at 2), because the Third Circuit's decision conforms fully to the teachings of this Court and the holdings of Delaware's courts.

C. THE THIRD CIRCUIT WAS NOT OBLIGATED TO ACCEPT THE DISTRICT COURT'S STATE LAW RULINGS.

The primary argument made in the Petition for Certiorari is that the Third Circuit failed to accord sufficient deference to the decisions made by the three district court judges who rendered decisions on the third-party beneficiary and economic loss issues at various stages of the litigation. However, the Court of Appeals did give the district court's rulings the weight they deserved, and in any event Petitioners' argument is insufficient to warrant the granting of certiorari by this Court.

As a threshold matter, it bears emphasis that Petitioners' briefs on the merits in the Third Circuit did not raise the deference argument they are now pressing in this Court. Quite to the contrary, Nemours' Brief affirmatively stated, with respect to both the third-party beneficiary and economic loss issues, that *"[t]he standard of review for this issue is plenary"*. (Brief for Nemours filed June 24, 1988 at pp. 1, 14-15) (emphasis added)[7] This Court's "normal practice" is to "refrain from addressing issues not raised in the Court of Appeals". *E.E.O.C. v. Federal Labor Relations Authority*, 476 U.S. 19, 24 (1986). *Accord Hoover v. Ronwin*, 466 U.S. 558, 574 n. 25 (1984) (refusing to consider argu-

7. Petitioners did not raise the deference argument until their January 18, 1989 Petition for Rehearing In Banc, which obviously came after the Third Circuit had already ruled against them.

ment first raised in response to motion for rehearing in court of appeals). Petitioners' failure to raise their deference argument in a timely manner in the Court of Appeals should preclude its consideration in this Court.

In addition, the Petition for Certiorari intentionally obscures the fact that neither of the two district judges who decided the third-party beneficiary issue rendered an opinion explaining his decision, and only one of the three district judges who decided the economic loss issue prepared an opinion in support of his ruling.

Judge Latchum (the first judge assigned to the case) decided the third-party beneficiary and economic loss issues in an "Omnibus Order" relating to sixteen different motions filed by five different parties, and he rendered his decisions as mere *ipse dixits* without an accompanying opinion, citation of *any* caselaw or reference to *any* of the provisions of the voluminous Gilbane-Pierce subcontract. (A47-48).

One year later, in March, 1985, Judge Stapleton did render an opinion on the economic loss issue in which he predicted that the Delaware Supreme Court would probably allow the maintenance of a negligence action to recover economic loss. (A61-67)[8] Judge Stapleton's opinion was in fact carefully considered by the Third Circuit (*See* A19-22), but it disagreed with his prediction of how the Delaware Supreme Court would decide the economic loss issue, correctly noting that there had been "significant developments in the law" on that issue during the 3½ years which had elapsed subsequent to the time of his prediction, particu-

8. It is noteworthy that although Judge Latchum's "Omnibus Order" of the prior year had already decided, *inter alia*, the economic loss issue, Judge Stapleton did not deem himself required to accord any deference to that unexplained ruling. Indeed, *nowhere* in his opinion did he even make any reference to it. Contrary to Petitioners' claim that they relied upon the rulings by both Judges Latchum and Stapleton in determining to settle with one another (Petition at 4), Judge Stapleton's opinion was rendered several weeks *after* Petitioners had already executed their Settlement Agreement. Also, Judge Stapleton only decided the economic loss issue; he was not asked to decide whether Nemours could maintain a third-party beneficiary claim against Pierce.

larly this Court's unanimous decision in *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986).

Finally, Judge Farnan decided the third-party beneficiary and economic loss issues in the context of Pierce's motion for a directed verdict, which he summarily denied from the bench by stating simply that he would follow Judge Latchum's Omnibus Order on those two issues as well as Judge Stapleton's opinion on the economic loss issue. (A75) Once again, there was no opinion rendered, no citations to *any* caselaw, and no discussion of *any* provisions in the Gilbane-Pierce subcontract.

Thus, with respect to the third-party beneficiary issue, *none* of the district judges ever rendered an opinion or even discussed *any* of the provisions of the Gilbane-Pierce subcontract. Under such circumstances, it cannot reasonably be contended that the Third Circuit was obligated to accept the district court's rulings on the third-party beneficiary issue.[9] Indeed, even though Judge Sloviter dissented from the Court's decision on that issue, she did not criticize the

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9. *See, e.g., Besta v. Beneficial Loan Co.*, 855 F.2d 532, 533-4 (8th Cir. 1988) ("When reviewing an interpretation of state law by a resident federal judge, however, we accord substantial deference to the interpretation unless we believe it does not correctly apply local law, or unless the judge has not expressed adequate reasons for the ruling on the state law question. Here, the judge did not supply us with his reasoning on what we believe to be the relevant question. We, therefore, believe that our deference must yield to reasoning we find more compelling."); *Dean v. Dean*, 821 F.2d 279, 283 n. 4 (5th Cir. 1987) ("Any deference to the district court is also less where the court fails to set out any analysis in predicting how the state's highest court would rule on a novel question of state law or if the interpretation of the state law is deficient in analysis or otherwise lacking in reasoned authority."); *Weiss v. United States*, 787 F.2d 518, 525 (10th Cir. 1986) ("When a district court fails to set out its analysis in predicting how the state's highest court would rule on a novel question of state law, we need not defer to the district court."); *Rabon v. Guardsmark, Inc.* 571 F.2d 1277, 1279 n. 1 (4th Cir. 1978), *cert. denied*, 439 U.S. 866 (1978) ("The district court decided the [state law] issue of liability in an oral opinion. It gives us little aid in deciding this appeal. It contains no citation of authority . . . While we normally accord significant weight to a district judge's interpretation of the law of the state in which he sits . . . we cannot do so under the circumstances described.").

majority for failing to accord sufficient deference to the district court's unexplained rulings.

With respect to the economic loss issue, only Judge Stapleton had rendered an opinion, and the Third Circuit did give due consideration to that opinion. (A19-22) However, subsequent developments in the law properly led the Court of Appeals to conclude that the Delaware Supreme Court would decide that issue differently than he had predicted. The Third Circuit accorded deference to Judge Stapleton's prediction, but was certainly not bound by it. As Justice Frankfurter stated in his concurring opinion in *Bernhardt v. Polygraphic Company of America*, 350 U.S. 198, 209 (1956), "[t]he defendant is entitled to have the view of the Court of Appeals on Vermont law and cannot, under the Act of Congress, be foreclosed by the District Court's interpretation."[10]

Thus, it is manifest that the Third Circuit's disagreement with the district court's rulings on the third-party beneficiary and economic loss issues does not warrant review by this Court.

D. THE THIRD CIRCUIT DETERMINED THE STATE LAW ISSUES CORRECTLY.

1. The Third-Party Beneficiary Issue.

Remarkably, *nowhere* in their Petition for Certiorari do the Petitioners make *any* reference to the provision incorporated into the Gilbane-Pierce subcontract upon which the Third Circuit principally relied in determining that Nemours was not an intended third-party beneficiary of

10. *Accord Ward v. Hobart Manufacturing Co.*, 450 F.2d 1176, 1180 n. 5 (5th Cir. 1971):

> We accord proper consideration to the 'rational divination' of the district court to determine what decision the Mississippi Supreme Court would reach if and when the question here presented is resolved by that court. Nevertheless, we cannot adopt the district court's view of the applicable state law if in our judgment that view is contrary to the more cogent reasoning of the best and most wide-spread authority. Otherwise appellate review in a substantial number of diversity cases which come before this court would be effectively eliminated.

that subcontract. That provision, which is Article 1.1.2 of the American Institute of Architects' "General Conditions of the Contract of Construction" (1976 ed.) (the "AIA General Conditions"), makes it pellucidly clear that Gilbane and Pierce expressly *disavowed* any intent to confer third-party beneficiary status upon Nemours:

> Nothing contained in the Contract Documents shall create any contractual relationship between the Owner [Nemours] or the Architect and any Subcontractor [Pierce] or Sub-subcontractor. (A14)

The Third Circuit correctly recognized that, under Delaware law, "[t]he intent to confer a third party beneficiary benefit is to be determined from the language of the contract. *Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver, Inc.*, 336 A.2d 211, 215 (Del. 1975); *Royal Indemnity Co. v. Alexander Industries, Inc.*, 8 Storey 548, 58 Del. 548, 211 A.2d 919, 920 (1965)". (A10) After carefully analyzing Article 1.1.2 of the AIA General Conditions and numerous other similar provisions of the subcontract, the Third Circuit properly concluded that "the subcontract does not manifest an intent by Pierce and Gilbane to confer third party beneficiary status upon Nemours. *In fact, the subcontract evidences an intent to preclude such a status*". *(A18) (emphasis added)*[11]

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11. In addition to Article 1.1.2, the Court cited many other provisions incorporated into the subcontract which demonstrated that "Gilbane and Pierce contemplated that Pierce was to be obligated to Gilbane, not to Nemours". (A13) These provisions stated as follows: "The *Subcontractor* [Pierce] agrees to be bound to the *Contractor* [Gilbane] by the terms and conditions of the Agreement . . . and to assume toward the *Contractor* all the obligations and responsibilities that the *Contractor*, by these documents, assumes toward the *Owner* [Nemours]". (emphasis in original) (A13); "The *Contractor* shall have *sole* and *total responsibility* for completing the [general] contract . . . and is responsible to the *Owner* for the full, proper, and timely performance of all work under the contract". (emphasis in original) (A14); "The *Contractor* shall be responsible to the *Owner* for the acts and omissions of his employees, *Subcontractors* and their agents and employees . . ." (emphasis in original) (A14); "Section 7(f) of the subcontract provides that if Pierce fails to perform, Gilbane may provide labor, equipment or materials or may terminate Pierce and complete the work itself. Section 38E of the Special conditions provides that the *subcontractor's* payment and performance bond shall name *Gilbane* as obligee". (emphasis in original) (A13-14)

As the Third Circuit correctly stated, no Delaware court has ever construed the meaning of Article 1.1.2 of the AIA General Conditions which is quoted above. (A15) However, the Court pointed out that there are a number of decisions from other jurisdictions which have construed that provision, and those decisions *uniformly* hold that it "prevents an owner from maintaining a breach of contract action against a subcontractor on a third party beneficiary theory, or prevents a subcontractor from maintaining a breach of contract action against an owner on such a theory". (A15) *See, e.g., E.C. Ernst, Inc. v. Manhattan Constr. Co. of Texas*, 551 F.2d 1026, 1030-1, 1042 (5th Cir. 1977), *cert. denied*, 434 U.S. 1067 (1978); *Honey v. George Hyman Construction Co.*, 63 F.R.D. 443, 450 (D.D.C. 1974); *Federal Mogul Corp. v. Universal Constr. Co.*, 376 So.2d 716, 724 (Ala. Civ. App. 1979), *cert. denied*, 376 So.2d 726 (Ala. 1979); *G & P Electric Co. v. Dumont Construction Co.*, 194 Cal. App.2d 868, 15 Cal. Rptr. 757, 761-3 (1961); *Delta Electric, Inc. v. Ingram and Greene, Inc.*, 123 App.Div.2d 369, 506 N.Y.S.2d 594 (1986).

Petitioners' argument that the decision in *Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver, Inc.*, 336 A.2d 211 (Del. 1975), was improperly "disregarded" by the Third Circuit is completely spurious. The Third Circuit gave careful consideration to the *Cannon* decision (*See* A10, A12, A17), and correctly determined that *Cannon* was not controlling in this case because the subcontract at issue there, unlike the Gilbane-Pierce subcontract, did not contain any provisions which *expressly renounced* an intent to confer third-party beneficiary status upon the owner. Equally erroneous is Petitioners' argument that the Third Circuit improperly based its decision on factors external to the subcontract. As stated above, the Third Circuit carefully analyzed numerous provisions of the Gilbane-Pierce subcontract (including the provisions relied upon by Petitioners), and based its decision solely on the express language of that subcontract. (*See* A5-6, A13-15)

Accordingly, the Third Circuit's decision on the third-party beneficiary issue is fully consistent with applicable Delaware law.[12]

2. The Economic Loss Issue.

The Third Circuit's decision that Nemours could not maintain a negligence action against Pierce for the recovery of mere economic loss also represents a proper determination of Delaware law pursuant to this Court's mandate in *Erie*.

As Petitioners concede, the Delaware Supreme Court has never addressed the economic loss issue, and therefore they cannot claim that the Third Circuit's decision is contrary to any controlling Delaware Supreme Court decision. There has been only one Delaware lower court decision which has addressed the economic loss question, and in that case Judge Andrew Christie (now Chief Justice of Delaware's Supreme Court) squarely held, on facts nearly identical to the instant case, that an owner which was not in privity with a subcontractor could not sue the subcontractor in negligence to recover mere economic loss. *Crowell Corp. v. Topkis Construction Co.*, 280 A.2d 730 (Del. Super. 1971).

The Third Circuit properly recognized that it was not bound by the *Crowell* decision (A20), but predicted that the Delaware Supreme Court would, if the issue were raised before it, reaffirm the *Crowell* ruling as Delaware law. (A22-23)[13] This prediction was not inconsistent with the Delaware Supreme Court's decisions in *Oliver B. Cannon & Sons, Inc. v. Dorr-Oliver, Inc.*, 336 A.2d 211 (Del. 1975) or

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12. As noted previously (p. 3, n. 2, *supra*), that decision is also in accordance with the position which Petitioners Gilbane and Aetna repeatedly and consistently asserted in the district court during the two years of litigation preceding their settlement with Nemours.

13. Notwithstanding Petitioners' criticism of *Crowell* as "outdated", it bears reiteration that Petitioner Gilbane vigorously argued in the district court that Delaware does not allow the maintenance of a negligence action for the recovery of mere economic loss. *See* p. 3, *supra*.

Seiler v. Levitz Furniture Co., 367 A.2d 999 (Del. 1976) because, as the Third Circuit correctly pointed out, both of those cases involved "(i) property damage, not merely economic loss and (ii) privity of contract between the injured party and the wrongdoer". (A21, A22).

As discussed above (p. 8, *supra*), Judge Stapleton had predicted in March, 1985 that the Delaware Supreme Court would not follow the *Crowell* decision. However, the Third Circuit disagreed with that prediction, finding that "[r]ecent developments in the law suggest a trend to preclude the maintenance of a negligence action to recover purely economic loss". (A21) The primary catalyst for that recent trend was this Court's unanimous decision in *East River S.S. Corp. v. Transamerica Delaval*, 476 U.S. 858 (1986), where the Court held in the admiralty context that purely economic loss was recoverable only in contract, not in tort. Even though *East River* was an admiralty case, its cogent reasoning has been widely followed by courts in numerous other areas of the law, including construction litigation. The vast majority of jurisdictions now hold that the economic loss rule applies in construction disputes.[14]

Judge Stapleton's March, 1985 prediction preceded the decisions in *East River* and its progeny, which reflect a strong and growing trend in the law to preclude the maintenance

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14. *See, e.g., Morse/Diesel, Inc. v. Trinity Industries, Inc.*, 859 F.2d 242 (2d Cir. 1988); *Bagwell Coatings, Inc. v. Middle South Energy, Inc.*, 797 F.2d 1298, 1309-12 (5th Cir. 1986); *Bryant Elec. Co., Inc. v. City of Fredericksburg*, 762 F.2d 1192 (4th Cir. 1985); *Chicago Heights Venture v. Dynamit Nobel of America*, 782 F.2d 723, 726-9 (7th Cir. 1986); *Blake Construction Co., Inc. v. Alley*, 233 Va. 31, 353 S.E. 2d 724 (1987); *Anderson Electric, Inc. v. Ledbetter Erection Corp.*, 115 Ill.2d 146, 503 N.E.2d 246 (1987); *Stuart v. Coldwell Banker Comm. Group*, 745 P.2d 1284, 1290-2 (Wash. 1987); *Tusch Enterprises v. Coffin*, 740 P.2d 1022, 1025-6 (Idaho 1987); *Ellis v. Robert C. Morris, Inc.*, 513 A.2d 951 (N.H. 1986); *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617 (Tex. 1986); *Minneapolis Society of Fine Arts v. Parker-Klein Associates Architects, Inc.*, 354 N.W.2d 816 (Minn. 1984); *Nebraska Innkeepers, Inc. v. Pittsburgh-Des Moines Corp.*, 345 N.W.2d 124, 126-9 (Iowa 1984); *State for Use of Smith v. Tyonek Timber, Inc.*, 680 P.2d 1148 (Alaska 1984).

of negligence claims for purely economic loss.[15] The Third Circuit's disagreement with Judge Stapleton and its prediction that the Delaware Supreme Court would follow the decisions in *East River* and *Crowell* and disallow the maintenance of a negligence claim for mere economic loss were eminently reasonable and are not worthy of review by this Court.

CONCLUSION

This case presents only issues of state law which were decided in complete conformity with this Court's teaching in *Erie* and with the applicable decisions of Delaware's state courts. The Third Circuit's decision does not conflict with any decision by this Court or by a court of appeals from another circuit, and thus there exist no "special and important" reasons for granting certiorari in this case. The Petition for Certiorari should be denied.

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15. Indeed, Judge Stapleton subsequently authored an opinion for the Court of Appeals which disallowed a jury verdict where the plaintiff had recovered in negligence for his purely economic loss. *King v. Hilton-Davis*, 855 F.2d 1047 (3d Cir. 1988), *cert. denied*, 109 S. Ct. 839 (1989). In that decision, Judge Stapleton acknowledged that his opinion for the Court was contrary to a decision reached on identical facts by Montana's Supreme Court in 1984, but he emphasized that that Court "did not have the benefit of the analysis of the Supreme Court in *East River*". 855 F.2d at 1052 n. 3. Similarly, in the instant case, Judge Stapleton "did not have the benefit of the analysis" of *East River* when he ventured his March, 1985 prediction.

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No. 88-1790

IN THE

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October Term, 1988

THE NEMOURS FOUNDATION, GILBANE BUILDING COMPANY, AND THE AETNA CASUALTY & SURETY COMPANY,

Petitioners,

v.

PIERCE ASSOCIATES, INC. AND FEDERAL INSURANCE CO.,

Respondents.

REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Either Pierce Associates and Federal Insurance Co. do not understand the contentions raised in the petition for certiorari, or they are intentionally obfuscating those issues in an effort to mislead this Court.

The issue before this Court is *not* whether an owner can sue a subcontractor on a third party beneficiary basis in Delaware, or whether an owner may recover in tort in Delaware for economic damages, although we believe the answer to both those questions is in the affirmative. Rather, the issue is whether in a diversity case governed by Delaware law, a court of appeals may disregard the interpretation of substantive state law by the highest court of that state as well as

similar interpretations of that substantive law by three experienced federal district court judges sitting in Delaware, and, through a process referred to as "predicting" the state substantive law, establish what amounts to federal common law—a result squarely prohibited by *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938).

SIGNIFICANT PROCEDURAL DEVELOPMENTS HAVE OCCURRED SINCE THE FILING OF THE PETITION FOR A WRIT OF CERTIORARI

The foregoing analysis, itself, would represent a cogent basis for the grant of certiorari. As respondents note, however, *Brief in Opposition to Petition* at 5 n.6, a further significant ground has emerged since the petition for certiorari was filed.

The day before the petition was filed, but in a separate action based on the same substantive issues, the Delaware district court, seeking a firm and unarguable resolution, entered an order certifying two questions identical to the underlying state law questions in this case to the Delaware Supreme Court under Rule 41 of the Delaware Supreme Court.[1] *Nemours v. Manganaro*, No. 89-00138 (D. Del. May 2, 1989) ("*Manganaro I*"). The Certificate of Questions of Law was transmitted to the Delaware Supreme Court by letter dated May 8, 1989.

Respondents and Manganaro have done everything possible to frustrate the certification procedure. In its certification order, the district court permitted Pierce to participate as

1. Rule 41 states that the United States District Court for the District of Delaware can "certify to [the Delaware Supreme] Court . . . a question of law arising in any case before it prior to the entry of final judgment if there is an important and urgent reason for an immediate determination of such question by this Court." Delaware Supreme Court Rule 41.

amicus curiae in the *Manganaro* case. Pierce and Federal subsequently used that status to interfere repeatedly with the certification proceedings ordered in *Manganaro I*. On the same day the district court sent the Certificate to the Delaware Supreme Court, Pierce and Federal filed a petition for writ of mandamus in the United States Court of Appeals for the Third Circuit, requesting that court to vacate the Delaware district court's certification order in *Manganaro I*. Simultaneously, Manganaro filed a notice of appeal from the same order of the district court. Both Pierce and Manganaro petitioned the court of appeals to stay the certification proceedings.

Pierce and Federal also sought to have the Delaware district court withdraw its Certificate. In addition, Pierce and Federal have cooperated with Manganaro to barrage the Delaware Supreme Court with unsolicited motions and memoranda of law despite the provision of Delaware Supreme Court Rule 41 that "[a]fter docketing and unless otherwise ordered, this Court shall thereupon and *without further argument* determine whether to accept or refuse the certification" (emphasis added).[2]

The district court rejected the effort of Pierce and Federal, and the Court of Appeals for the Third Circuit has now dismissed the petition for mandamus, as well as the appeal, *Nemours v. Manganaro*, ___ F.2d ___, No. 89-3305, slip op. at 4 (3d Cir. May 26, 1989) ("*Manganaro II*"), and the

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2. On May 10, 1989, Pierce filed a motion for leave to file a memorandum on issues of law relating to the Certificate. The next day, Manganaro filed a similar motion. On June 6, Pierce moved yet again for leave to file an additional memorandum of law with the Delaware Supreme Court.

Indeed, the length respondents have been willing to go to prevent the highest court of Delaware from determining its own law is remarkable. This persistent attempt to prevent the Delaware Supreme Court from declaring the "truth"—i.e., the answers to the underlying Delaware state law questions presented here—is highly questionable conduct.

related stay petitions, thus making it possible for the highest court of Delaware to decide definitively the two substantive issues governing the outcome of this case, as contemplated by this Court's decision in *Erie*.

THE PETITION RAISES SUBSTANTIAL QUESTIONS OF FEDERALISM PURSUANT TO *ERIE RAILROAD v. TOMPKINS*

The thrust of the arguments raised by Pierce and Federal in opposition to the petition for certiorari is that this Court should defer to the state law determinations made by the 2-1 panel of the court of appeals because the court of appeals is more intimately involved with the law of the states in its circuit than is the United States Supreme Court. *Brief in Opposition to Petition* at 5.[3] Taken to its logical conclusion, respondents' argument supports the force of Nemours' position, not its own.

Just as the court of appeals may be in a better position to determine the law of the states in its circuit than is the Supreme Court, so the district court is in a better position to determine the law of the state in which it sits than is the court of appeals. The legal principle is one of federalism, which encompasses deference to that court most familiar with state

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3. Respondents also assert that Nemours' failure to press its deference argument before the court of appeals panel precludes its consideration at this time. *Brief in Opposition to Petition* at 7-8. This latter contention is clearly fallacious. Nemours could not possibly have argued that the panel erred in not according deference to the Delaware district court's state law determinations prior to the time that the panel did, in fact, refuse to defer. It was not until the court of appeals rejected the considered opinions of the three Delaware district court judges that the deference contention became relevant; at that point Nemours immediately proceeded to argue it strenuously. *See Petition of The Nemours Foundation and Gilbane Building Company for Rehearing and Suggestion of Rehearing In Banc* at 5-7.

law, not, as respondents suggest, deference to the courts of appeals *per se*. *See United States v. Hohri*, ___ U.S. ___, 107 S. Ct. 2246, 2253 n.6 (1987); *Bernhardt v. Polygraphic Company of America, Inc.*, 350 U.S. 198, 204 (1955).[4] It would be anomalous indeed if, as respondents argue, the principle of deference ended with the courts of appeals rather than extending to the district courts and the state courts themselves that are far more knowledgeable of the state law issues at hand.

This case presents a striking example of the importance of deferring out of federalism principles to that court closest to the state whose law is at issue. Here, three Delaware district court judges independently arrived at identical state law determinations on three separate occasions. The panel of the court of appeals that reversed the district court's state law determinations consisted of a New Jersey district court judge sitting by designation, who wrote the majority opinion; a judge newly-appointed to the court of appeals from the Pennsylvania state courts, who joined it; and an experienced court of appeals judge, who dissented on the central issue. Given the circumstances, it would be ironic indeed for this Court to defer to the state law determinations of the court of appeals, when the court of appeals itself completely disregarded the state law determinations of the district court and the highest court of Delaware.

The Third Circuit itself has recognized the importance of the state law questions that the panel had answered contrary to the determinations made by the Delaware district court

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4. The authorities upon which respondents rely do not distinguish between deference to the court of appeals and deference to the district court, but state the proposition broadly. *See, e.g., Bowen v. Massachusetts*, ___ U.S. ___, 108 S. Ct. 2722, 2739 (1988); *Sheridan v. United States*, ___ U.S. ___, 108 S. Ct. 2449, 2455 (1988); *Cort v. Ash*, 422 U.S. 66, 73 n.6 (1975); *see also Frisby v. Schultz*, ___ U.S. ___, 108 S. Ct. 2495, 2500 (1988); *Bishop v. Wood*, 426 U.S. 341, 345 (1975); *MacGregor v. State Mutual Life Assurance Co.*, 315 U.S. 280, 281 (1942) (*per curiam*).

judges. In dismissing Manganaro's appeal, it observed that the status of Delaware law on these issues is "probably the determinative legal issue in the underlying merits," *Manganaro II*, slip. op. at 5, and thus found that the certification order did not meet the second "separate from the merits" prong of *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949), so as to justify interlocutory review.

Plainly, the state law questions presented for review here, if answered definitively by the Delaware Supreme Court in *Manganaro I*, will dispose of any lingering uncertainties over the very heart of this case created by the court of appeals panel's abrupt reversal of three Delaware district judges on questions of Delaware state law. When the highest court of a state stands poised to determine definitively the very questions of state law about which the federal courts below have so sharply disagreed, we respectfully suggest that this Court should permit that process to unfold.

CONCLUSION

Contrary to respondents' arguments, the decision of the Court of Appeals for the Third Circuit poses multiple issues of federalism under *Erie* deserving of the Court's attention and merits review by this Court even if the Delaware Supreme Court were to deny certification. At the very least, however, the Court should defer consideration of the petition for writ of certiorari pending the outcome of the certification procedure in the Delaware Supreme Court. Should the Delaware Supreme Court grant certification and determine Delaware law contrary to the findings of the court of appeals, this Court then could grant the writ of certiorari and simply remand this case to the court of appeals for appropriate disposition in light of the Delaware Supreme Court's ruling. This is the clear command of *Erie*, namely, that in a diversity action the applicable law of the state must govern.

Were this Court to deny certiorari at this time, it is quite possible that a definite ruling of the Delaware Supreme Court on the underlying issues of Delaware law governing the present dispute would be of no consequence, thus defeating the very purpose of *Erie*, and repudiating the principle of federalism that is mandated by the United States Constitution.

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Respondents submit this Supplemental Brief pursuant to Supreme Court Rule 22.6 solely in order to bring to this Court's attention the important decision rendered by the Delaware Supreme Court on June 14, 1989 in *The Nemours Foundation v. Manganaro Corporation, New England,* No. 189, 1989. In that unanimous decision, authored by Chief Justice Christie, the Court *refused* to accept certification of the *same* two issues of Delaware law raised in the Petition for Certiorari in this case — to wit, (1) whether Nemours could sue Gilbane's subcontractors as a third-party beneficiary of those subcontracts; and (2) whether Nemours could maintain negligence claims against the subcontractors for recovery of its mere economic loss.

The Reply Brief filed by Petitioners in this Court on June 10, 1989 was devoted almost exclusively to the certification proceeding recently initiated by Nemours against Manganaro, which Petitioners claimed constituted "a further significant ground" for granting certiorari. (Reply Brief at 2). Petitioners argued that "the Court should defer consideration of the petition for writ of certiorari pending the outcome of the certification procedure in the Delaware Supreme Court." (Reply Brief at 6). Now that the certification proceeding has run its course, there is simply no reason to defer adjudication of the Petition for Certiorari, as requested by Petitioners.

Respondents agree with Petitioners that the denouement of the *Manganaro* certification proceeding is indeed highly "significant" here, as the Delaware Supreme Court is the tribunal with the greatest interest in the predictions of Delaware law which the Third Circuit made in this case. The Delaware Supreme Court has now deemed those determinations unworthy of its review by means of certification, and so too should this Court deem those state law rulings unworthy of its review by certiorari. The Petition for Certiorari should be denied.

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